Westpac Banking Corporation - New Zealand Division

Disclosure Statement

For the year ended 30 September 2012

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General information and definitions

Certain of the information contained in this Disclosure Statement is required by section 81 of the Reserve Bank of New Zealand Act 1989 (‘**Reserve Bank Act**’) and the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 2) 2012 (‘**Order**’).

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

- Westpac Banking Corporation Group (otherwise referred to as the ‘**Overseas Banking Group**’) – refers to the total worldwide business of Westpac Banking Corporation including its controlled entities;
- Westpac Banking Corporation (otherwise referred to as the ‘**Overseas Bank**’) – refers to the worldwide activities of Westpac Banking Corporation excluding its controlled entities;
- Westpac Banking Corporation New Zealand Division (otherwise referred to as the ‘**NZ Banking Group**’) – refers to the New Zealand operations of Westpac Banking Corporation Group including those entities whose business is required to be reported in the financial statements of the Overseas Banking Group’s New Zealand business. Controlled entities of the NZ Banking Group as at 30 September 2012 are set out in Note 26 Related entities;
- Westpac Banking Corporation New Zealand Branch (otherwise referred to as the ‘**NZ Branch**’) – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac); and
- Westpac New Zealand Limited (otherwise referred to as ‘**Westpac New Zealand**’) – refers to a locally incorporated subsidiary of the Overseas Bank (carrying on the Overseas Bank’s New Zealand consumer, business and institutional banking operations).

Words and phrases not defined in this Disclosure Statement, but defined by the Order, have the meaning given by the Order when used in this Disclosure Statement. All amounts referred to in this Disclosure Statement are in New Zealand dollars unless otherwise stated.

On 1 November 2011, the NZ Branch transferred additional business activities and associated employees to Westpac New Zealand (refer to Note 2 Transfer of operations from NZ Branch to Westpac New Zealand for further details).

General matters

Registered Bank

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

Overseas Bank

The Overseas Bank was founded on 12 February 1817 and was incorporated on 23 September 1850 pursuant to the Bank of New South Wales Act 1850. In 1982 the Overseas Bank acquired The Commercial Bank of Australia Limited and the Overseas Bank changed its name to Westpac Banking Corporation. On 23 August 2002 the Overseas Bank registered as a public company limited by shares under the Australian Corporations Act 2001 and as of that date the Bank of New South Wales Act 1850 ceased to apply.

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

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

On 1 November 2011, the NZ Branch transferred additional business activities and associated employees to Westpac New Zealand (refer to Note 2 Transfer of operations from NZ Branch to Westpac New Zealand for further details).

As a registered bank, Westpac New Zealand is required to produce its own disclosure statement. Accordingly, further information on Westpac New Zealand is available in Westpac New Zealand’s Disclosure Statement for the year ended 30 September 2012.

Registered bank: Directorate

Directors

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

Name: Lindsay Philip Maxsted, DipBus (Gordon), FCA, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Chairman of each of Transurban Holdings Limited, Transurban Infrastructure Management Limited and Transurban International Limited. Director of each of BHP Billiton Limited, BHP Billiton plc, Align Capital Pty Ltd, Align Investments Pty Ltd, Baker IDI Heart and Diabetes Institute Holdings Limited, Belmont Pty Limited, Centip Pty Ltd, Continuum Investments Pty Ltd and Jacobite Investments Pty Ltd.

General matters (continued)

Name: Gail Patricia Kelly, HigherDipED, BA, MBA, HonDBus **Non-executive:** No **Country of Residence:** Australia **Primary Occupation:** Managing Director & Chief Executive Officer, Westpac Banking Corporation **Secondary Occupations:** Director **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Director of each of the Australian Bankers' Association, the Business Council of Australia, the Financial Markets Foundation for Children and G&A Kelly Investments Pty Limited. Member of the US Council on Foreign Relations Global Board of Advisors and the Sydney Cricket and Sports Ground Trust. Care Australia's Ambassador for Women's Empowerment.
Name: John Simon Curtis AM, BA, LLB (Hons.) **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Allianz Australia Limited. Director of each of Allianz Australia Insurance Limited, Allianz Australia Life Insurance Limited, Cetinale Pty Limited, CIC Allianz Insurance Limited, Mirapoint Pty Limited, Rowshore Pty Limited, Sitruc Pty Ltd, South Sydney Central Pty Limited, Stourhead Holdings Pty Limited and Stowe Securities Pty Limited.
Name: Elizabeth Blomfield Bryan, BA (Econ.), MA (Econ.) **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of each of Caltex Australia Limited, Caltex Australia Petroleum Pty Ltd and Caltex Australia Custodians Pty Ltd. Director of the E. Bryan Superannuation Fund Pty Ltd.
Name: Gordon McKellar Cairns, MA (Hons.) **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Origin Foundation Pty Limited. Director of each of Ceilidh Pty Limited, Origin Energy Limited, Piobaireachd Pty Ltd and World Education Australia Limited. Executive Chairman of Quick Service Restaurant Group Pty Ltd.
Name: Robert George Elstone, BA (Hons.), MA (Econ.), MCom **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chairman **Independent Director:** Yes	**External Directorships:** Director of each of R & S Elstone Pty Ltd, Elstone Investments Pty Limited and R Elstone Pty Limited.
Name: Peter John Oswin Hawkins, BCA (Hons.), SF Fin, FAIM, ACA (NZ), FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of each of Clayton Utz, Joshawk Investments Pty Ltd, Liberty Financial Pty Ltd, Liberty Fiduciary Pty Ltd, Lynter Investments Pty Ltd, LFI Group Pty Ltd, Minerva Financial Group Pty Limited, Mirvac Funds Limited, Mirvac Limited, Murray Goulburn Co-operative Company Limited, Petlyn Holdings Pty Limited and the Treasury Corporation of Victoria.

General matters (continued)

Name: Ann Darlene Pickard, BA, MA
Non-executive: Yes
Country of Residence: Australia
Primary Occupation: Director
Secondary Occupations: None
Board Audit Committee Member: No
Independent Director: Yes

External Directorships: Director of each of Shell Energy Holdings Australia Limited, Shell Development (Australia) Pty Ltd, Shell Development (PSC19) Pty Ltd, Shell Development (PSC20) Pty Ltd, Shell Eastern Australia Pty Ltd, Shell Energy Investments Australia Pty Ltd, Shell Finance (Australia) Pty Ltd, Shell Global Solutions Australia Pty Ltd, Arrow Energy Holdings Pty Ltd, and the Energy & Minerals Institute, University of Western Australia.

The following changes in the composition of the Board have been effected since 30 September 2011:

- Ann Pickard was appointed to the Board effective on 1 December 2011. Ms Pickard is an independent Non-executive Director and has over 25 years of international experience as a senior manager in large organisations;
- Ted Evans retired as Chairman following the 2011 Annual General Meeting on 14 December 2011. Ted Evans was succeeded as Chairman by Lindsay Maxsted;
- Graham Reaney retired following the 2011 Annual General Meeting on 14 December 2011;
- Robert Elstone was appointed to the Board effective 1 February 2012. Mr Elstone is an independent Non-executive Director. Prior to his appointment he was Managing Director and CEO of ASX Limited;
- Carolyn Judith Hewson resigned from the Board with effect from 30 June 2012;
- Peter Wilson retired from the Board following the 2012 Annual General Meeting on 13 December 2012; and
- Robert Elstone was appointed as Chairman of Overseas Bank Board Audit Committee effective 13 December 2012.

Chief Executive Officer, NZ Branch

Name: Karen Lee Ann Silk, B.Com
Country of Residence: New Zealand
Primary Occupation: Chief Executive Officer, NZ Branch
Secondary Occupations: General Manager, Westpac Institutional Bank
External Directorships: Director of Waianawa Pastoral Limited

Responsible person

As announced on 9 March 2012 and effective on 2 April 2012, Peter Graham Clare was appointed Chief Executive of Westpac New Zealand, replacing George Frazis as Chief Executive of Westpac New Zealand.

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

Name: Peter Graham Clare, B.Com, MBA
Country of Residence: New Zealand
Primary Occupation: Chief Executive, Westpac New Zealand
Secondary Occupations: Director

Address for communications

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

Conflicts of interest policy

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

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

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

General matters (continued)

Interested transactions

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

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

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

Auditors

NZ Banking Group

PricewaterhouseCoopers

PricewaterhouseCoopers Tower

188 Quay Street

Auckland

New Zealand

Credit ratings

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

Rating Agency	Current Credit Rating	Rating Outlook
Fitch Ratings	AA-	Stable
Moody's Investors Service	Aa2	Stable
Standard & Poor's	AA-	Stable

On 30 January 2012, Fitch Ratings ('**Fitch**') placed the Overseas Bank's credit rating outlook on 'rating watch negative'. The announcement by Fitch formed part of a broader review of the debt ratings Fitch applies to the largest banking institutions in the world. On 24 February 2012, the Overseas Bank's credit rating issued by Fitch was downgraded from AA to AA- with a 'stable' outlook.

On 9 November 2011, Standard & Poor's released its new global bank rating criteria and Banking Industry Country Risk Assessments ('**BICRA**') methodology. Also on 9 November 2011, Standard & Poor's announced the BICRA score for Australia of two, down from a score of one under the previous methodology. On 1 December 2011, as a result of the Standard & Poor's bank rating criteria changes, the Overseas Bank's credit rating was lowered from AA to AA- with a 'stable' outlook.

On 18 May 2011, the Overseas Bank's credit rating issued by Moody's Investors Service was downgraded from Aa1 to Aa2 with a 'stable' outlook.

There have been no other changes to any of the Overseas Bank's credit ratings or rating outlooks in the two years prior to 30 September 2012.

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

Credit ratings (continued)

Descriptions of credit rating scales[1]

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

1 This is a general description of the rating categories based on information published by Fitch, Moody's Investors Service and Standard & Poor's.

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

Ratings stated in **bold** indicate the Overseas Bank's current position within the credit rating scales.

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

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

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2012 and can be accessed at the internet address www.westpac.com.au.

Historical summary of financial statements

$ millions	NZ Banking Group **Year Ended 30-Sep-12**	Year Ended 30-Sep-11	Year Ended 30-Sep-10[1]	Year Ended 30-Sep-09[2,3]	Year Ended 30-Sep-08[4]
Income statement					
Interest income	**3,965**	4,016	3,972	4,622	5,387
Interest expense	**(2,440)**	(2,482)	(2,562)	(3,142)	(4,049)
Net interest income	**1,525**	1,534	1,410	1,480	1,338
Non-interest income	**582**	509	532	610	572
Net operating income	**2,107**	2,043	1,942	2,090	1,910
Operating expenses	**(872)**	(845)	(788)	(808)	(814)
Impairment charges on loans	**(184)**	(226)	(332)	(690)	(181)
Operating profit	**1,051**	972	822	592	915
Share of profit of associate accounted for using equity method	**1**	1	1	-	48
Profit before income tax expense	**1,052**	973	823	592	963
Income tax expense	**(293)**	(307)	(60)	(1,086)	(281)
Profit/(loss) after income tax expense	**759**	666	763	(494)	682
Profit/(loss) after income tax expense attributable to:					
Head office account and owners of the NZ Banking Group	**756**	662	760	(497)	679
Non-controlling interests in subsidiary companies	**3**	4	3	3	3
	759	666	763	(494)	682
NZ Branch profit repatriation to the Overseas Bank	**-**	-	-	-	(602)
Dividends paid on ordinary share capital	**(4)**	(2)	(4)	(13)	(175)
Dividends paid on preference share capital	**-**	-	-	(104)	(15)
Dividends paid on convertible debentures (net of tax)	**(72)**	(70)	(70)	(69)	(66)
Balance sheet					
Total assets	**77,854**	78,293	72,529	73,444	70,882
Total impaired assets	**868**	919	890	676	278
Total liabilities	**72,339**	73,532	68,401	69,539	66,750
Total head office account	**1,513**	1,389	1,192	1,392	174
Total equity	**5,515**	4,761	4,128	3,905	4,132

1 During the year ended 30 September 2010 the NZ Branch repatriated $500 million of capital to the Overseas Bank.
2 During the year ended 30 September 2009 the Overseas Bank advanced capital of $1.8 billion to the NZ Branch.
3 Income tax expense includes a provision totalling $918 million in relation to nine structured finance transactions which occurred between 1998 and 2002 that were disputed by the New Zealand Commissioner of Inland Revenue.
4 During the year ended 30 September 2008, the NZ Branch repatriated $1.3 billion to the Overseas Bank from Branch capital ($698 million) and retained profits ($602 million).

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

Guarantee arrangements

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

Ranking of local creditors in liquidation

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

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

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

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

Section 13A(3) of the Australian Banking Act affects all unsecured liabilities of the NZ Branch, which, as at 30 September 2012, amounted to $15,054 million (30 September 2011: $20,326 million).

Section 13A(4) of the Australian Banking Act also provides that it is an offence for an ADI not to hold assets (other than goodwill and any assets or other amount excluded by the prudential standards) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia, unless APRA has authorised the ADI to hold assets of a lesser value. During the year ended 30 September 2012, the Overseas Bank has at all times held assets (other than goodwill) in Australia of not less than the value of the Overseas Bank's total deposit liabilities in Australia.

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

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

Pending proceedings or arbitration

There are no pending legal proceedings or arbitration at the date of this Disclosure Statement involving any member of the NZ Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on the Overseas Bank or the NZ Banking Group.

The Overseas Banking Group has worldwide contingent liabilities in respect of actual and potential claims and proceedings, which have not been determined. An assessment of the Overseas Banking Group's likely loss is made on a case-by-case basis and provisions are made where appropriate. Such contingencies are disclosed in the Overseas Banking Group's 30 September 2012 Annual Financial Report.

Other material matters

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

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

Conditions of registration

The conditions of registration imposed on Westpac Banking Corporation (the '**registered bank**') in New Zealand, which applied on and after 30 September 2011, are as follows:

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

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

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

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

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

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

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

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

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

   For the purposes of this condition of registration:

   - 'insurance business' means the undertaking or assumption of liability as an insurer under a contract of insurance:
   - 'insurer' and 'contract of insurance' have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

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

4. That no appointment to the position of the New Zealand Chief Executive Officer of the registered bank shall be made unless:

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

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

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

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

   (a) Tier One Capital of Westpac Banking Corporation is not less than 4% of risk-weighted exposures; and

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

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

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

In these conditions of registration:

- 'Banking Group' means the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements for the group's New Zealand business under section 9(2) of the Financial Reporting Act 1993;
- 'business of the registered bank in New Zealand' means the New Zealand business of the registered bank as required to be reported in financial statements under section 8(2) of the Financial Reporting Act 1993;
- 'generally accepted accounting practice' has the same meaning as in section 2 of the Financial Reporting Act 1993; and
- 'liabilities of the registered bank in New Zealand' means the liabilities of the registered bank as required to be reported in financial statements under section 8(2) of the Financial Reporting Act 1993.

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

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

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

(b) is not false or misleading.

Each Director of the Overseas Bank believes and the Chief Executive Officer, NZ Branch, believes, after due enquiry, that, over the year ended 30 September 2012:

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

(b) the NZ Branch had systems in place to monitor and control adequately the NZ Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk and other business risks and that those systems were being properly applied.

This Disclosure Statement has been signed on behalf of the Directors by Peter Graham Clare, Chief Executive, Westpac New Zealand, and Karen Lee Ann Silk, Chief Executive Officer, NZ Branch.

Peter Graham Clare

Karen Lee Ann Silk

Dated this the 20th day of December 2012

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Income statements for the year ended 30 September

$ millions	Note	NZ Banking Group Year Ended 30-Sep-12	NZ Banking Group Year Ended 30-Sep-11	NZ Branch Year Ended 30-Sep-12	NZ Branch Year Ended 30-Sep-11
Continuing operations:					
Interest income	2,3	**3,965**	4,016	**316**	226
Interest expense	2,3	**(2,440)**	(2,482)	**(158)**	(84)
Net interest income		**1,525**	1,534	**158**	142
Non-interest income:					
Fees and commissions	2,4	**321**	319	**15**	15
Wealth management revenue	2,4	**121**	90	**-**	-
Trading income	2,4	**116**	94	**118**	96
Net ineffectiveness on qualifying hedges	2,4	**1**	3	**-**	-
Other non-interest income/(expense)	2,4	**23**	3	**7**	(7)
Total non-interest income		**582**	509	**140**	104
Net operating income		**2,107**	2,043	**298**	246
Operating expenses	2,5	**(872)**	(845)	**(49)**	(45)
Impairment (charges)/recoveries on loans	2,7	**(184)**	(226)	**3**	(1)
Operating profit		**1,051**	972	**252**	200
Share of profit of associate accounted for using equity method		**1**	1	**-**	-
Profit before income tax expense		**1,052**	973	**252**	200
Income tax expense on operating profit	2,8	**(293)**	(288)	**(71)**	(73)
Income tax (expense)/benefit related to New Zealand structured finance transactions	2,8	**-**	(19)	**-**	26
Profit after income tax expense from continuing operations		**759**	666	**181**	153
Profit after income tax expense from discontinued operations	2	**-**	-	**15**	114
Profit after income tax expense		**759**	666	**196**	267
Profit after income tax expense attributable to:					
Head office account and owners of the NZ Banking Group:					
Profit after income tax expense from continuing operations	2	**756**	662	**181**	153
Profit after income tax expense from discontinued operations	2	**-**	-	**15**	114
		756	662	**196**	267
Non-controlling interests:					
Profit after income tax expense from continuing operations		**3**	4	**-**	-
		759	666	**196**	267

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Statements of comprehensive income for the year ended 30 September

$ millions	NZ Banking Group		NZ Branch	
	Year Ended 30-Sep-12	Year Ended 30-Sep-11	**Year Ended 30-Sep-12**	Year Ended 30-Sep-11
Profit after income tax expense	**759**	666	**196**	267
Other comprehensive income:				
Available-for-sale securities:				
Net unrealised gains from changes in fair value of available-for-sale securities	**66**	8	**-**	-
Exchange differences	**(6)**	(2)		
Cash flow hedges:				
Net gains from changes in fair value of cash flow hedges	**56**	63	**-**	-
Actuarial losses on employee defined benefit superannuation schemes	**(25)**	(15)	**-**	-
Income tax relating to components of other comprehensive income	**(20)**	(15)	**-**	-
Other comprehensive income, net of tax	**71**	39	**-**	-
Total comprehensive income	**830**	705	**196**	267
Total comprehensive income attributable to:				
Head office account and owners of the NZ Banking Group:				
Total comprehensive income for the year from continuing operations	**827**	701	**181**	153
Total comprehensive income for the year from discontinued operations	**-**	-	**15**	114
	827	701	**196**	267
Non-controlling interests:				
Total comprehensive income for the year from continuing operations	**3**	4	**-**	-
	830	705	**196**	267

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Statements of changes in equity for the year ended 30 September

$ millions	NZ Banking Group									
	Head Office Account			NZ Banking Group Equity						
	Branch Capital	(Accumulated Losses)/ Retained Profits	Convertible Debentures	Share Capital	Retained Profits	Cash Flow Hedge Reserve	Available-for-sale Securities Reserve	Total before Non-controlling Interests	Non-controlling Interests	Total Equity
As at 1 October 2010	1,300	(108)	1,284	139	1,599	(117)	25	4,122	6	4,128
Year ended 30 September 2011										
Profit after income tax expense	-	267	-	-	395	-	-	662	4	666
Net gains from changes in fair value	-	-	-	-	-	63	8	71	-	71
Exchange differences	-	-	-	-	-	-	(2)	(2)	-	(2)
Income tax effect	-	-	-	-	-	(20)	-	(20)	-	(20)
Actuarial losses on employee defined benefit superannuation schemes	-	-	-	-	(15)	-	-	(15)	-	(15)
Income tax effect	-	-	-	-	5	-	-	5	-	5
Total comprehensive income for the year ended 30 September 2011	-	267	-	-	385	43	6	701	4	705
Transactions with owners:										
Dividends paid on convertible debentures (net of tax)	-	(70)	-	-	-	-	-	(70)	-	(70)
Dividends paid on ordinary shares	-	-	-	-	-	-	-	-	(2)	(2)
As at 30 September 2011	1,300	89	1,284	139	1,984	(74)	31	4,753	8	4,761
Year ended 30 September 2012										
Profit after income tax expense	**-**	**196**	**-**	**-**	**560**	**-**	**-**	**756**	**3**	**759**
Net gains from changes in fair value	**-**	**-**	**-**	**-**	**-**	**56**	**66**	**122**	**-**	**122**
Exchange differences	**-**	**-**	**-**	**-**	**-**	**-**	**(6)**	**(6)**	**-**	**(6)**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**(16)**	**(11)**	**(27)**	**-**	**(27)**
Actuarial losses on employee defined benefit superannuation schemes	**-**	**-**	**-**	**-**	**(25)**	**-**	**-**	**(25)**	**-**	**(25)**
Income tax effect	**-**	**-**	**-**	**-**	**7**	**-**	**-**	**7**	**-**	**7**
Total comprehensive income for the year ended 30 September 2012	**-**	**196**	**-**	**-**	**542**	**40**	**49**	**827**	**3**	**830**
Transactions with owners:										
Dividends paid on convertible debentures (net of tax)	**-**	**(72)**	**-**	**-**	**-**	**-**	**-**	**(72)**	**-**	**(72)**
Dividends paid on ordinary shares	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(4)**	**(4)**
As at 30 September 2012	**1,300**	**213**	**1,284**	**139**	**2,526**	**(34)**	**80**	**5,508**	**7**	**5,515**

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Statements of changes in equity (continued) for the year ended 30 September

	NZ Branch			
	Head Office Account			
$ millions	Branch Capital	(Accumulated Losses)/ Retained Profits	Convertible Debentures	Total Equity
As at 1 October 2010	1,300	(108)	1,284	2,476
Year ended 30 September 2011				
Profit after income tax expense	-	267	-	267
Total comprehensive income for the year ended 30 September 2011	-	267	-	267
Transaction with owners:				
Dividends paid on convertible debentures (net of tax)	-	(70)	-	(70)
As at 30 September 2011	1,300	89	1,284	2,673
Year ended 30 September 2012				
Profit after income tax expense	**-**	**196**	**-**	**196**
Total comprehensive income for the year ended 30 September 2012	**-**	**196**	**-**	**196**
Transaction with owners:				
Dividends paid on convertible debentures (net of tax)	**-**	**(72)**	**-**	**(72)**
As at 30 September 2012	**1,300**	**213**	**1,284**	**2,797**

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Balance sheets as at 30 September

$ millions	Note	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Assets					
Cash and balances with central banks	2	**1,714**	1,871	**119**	514
Due from other financial institutions	10	**322**	699	**-**	-
Derivative financial instruments	2,27	**5,506**	6,060	**5,496**	5,976
Trading securities	2,11	**4,028**	6,065	**1,988**	2,803
Available-for-sale securities	12	**2,694**	1,518	**-**	-
Loans	2,13,14	**59,892**	58,114	**385**	401
Life insurance assets		**237**	186	**-**	-
Due from related entities	2,26	**2,006**	2,272	**9,685**	6,429
Investment in associate	26	**48**	48	**-**	-
Goodwill and other intangible assets	2,15	**652**	617	**6**	2
Property, plant and equipment		**162**	154	**-**	-
Deferred tax assets	2,16	**209**	231	**10**	9
Other assets	2,17	**384**	458	**162**	283
Total assets excluding assets of discontinued operations held for sale		**77,854**	78,293	**17,851**	16,417
Assets of discontinued operations held for sale	2	**-**	-	**-**	6,582
Total assets		**77,854**	78,293	**17,851**	22,999
Liabilities					
Due to other financial institutions	2,18	**214**	778	**211**	531
Deposits	2,19	**43,390**	39,575	**-**	-
Derivative financial instruments	2,27	**5,841**	5,448	**5,481**	5,364
Trading liabilities	2,20	**518**	1,286	**518**	1,286
Debt issues	21	**12,914**	17,630	**-**	-
Current tax liabilities	2	**49**	23	**29**	7
Provisions	2,22	**96**	92	**11**	4
Other liabilities	2,23	**721**	1,223	**122**	625
Total liabilities excluding liabilities to related entities and of discontinued operations held for sale		**63,743**	66,055	**6,372**	7,817
Subordinated debentures	2,24	**712**	785	**712**	785
Due to related entities	2,26	**7,884**	6,692	**7,970**	6,853
Total liabilities excluding liabilities of discontinued operations held for sale		**72,339**	73,532	**15,054**	15,455
Liabilities of discontinued operations held for sale	2	**-**	-	**-**	4,871
Total liabilities		**72,339**	73,532	**15,054**	20,326
Net assets		**5,515**	4,761	**2,797**	2,673
Equity					
Head office account					
Branch capital		**1,300**	1,300	**1,300**	1,300
Retained profits		**213**	89	**213**	89
Total head office account		**1,513**	1,389	**1,513**	1,389
Convertible debentures	25	**1,284**	1,284	**1,284**	1,284
NZ Banking Group equity					
Ordinary share capital		**139**	139	**-**	-
Retained profits		**2,526**	1,984	**-**	-
Cash flow hedge reserve		**(34)**	(74)	**-**	-
Available-for-sale securities reserve		**80**	31	**-**	-
Total equity attributable to owners of the NZ Banking Group		**2,711**	2,080	**-**	-
Non-controlling interests		**7**	8	**-**	-
Total equity		**5,515**	4,761	**2,797**	2,673
Interest earning and discount bearing assets		**69,024**	68,745	**9,141**	13,855
Interest and discount bearing liabilities		**60,877**	62,823	**7,613**	12,460

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Signed on behalf of the Board of Directors.

Director
20 December 2012

Gail Kelly
Director
20 December 2012

Statements of cash flows for the year ended 30 September

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Cash flows from operating activities				
Interest income received	**3,955**	4,025	**365**	575
Interest expense paid	**(2,436)**	(2,488)	**(178)**	(303)
Non-interest income received	**562**	437	**148**	73
Net decrease/(increase) in trading securities	**1,643**	(123)	**(1,534)**	551
Net (decrease)/increase in trading liabilities	**(768)**	1,047	**(768)**	1,047
Net movement in derivative financial instruments	**1,003**	(365)	**597**	(444)
Operating expenses paid	**(824)**	(744)	**(42)**	(60)
Income tax paid	**(240)**	(162)	**(20)**	(9)
Net cash provided by/(used in) operating activities	**2,895**	1,627	**(1,432)**	1,430
Cash flows from investing activities				
Purchase of available-for-sale securities	**(1,179)**	(1,468)	**-**	-
Proceeds from maturities of available-for-sale securities	**63**	-	**-**	-
Net loans (advanced to)/repaid by customers	**(1,962)**	(1,602)	**71**	(90)
Net increase in life insurance assets	**(51)**	(40)	**-**	-
Net decrease/(increase) in due from related entities	**266**	(971)	**(156)**	(933)
Purchase of capitalised computer software	**(73)**	(46)	**(6)**	(2)
Purchase of property, plant and equipment	**(36)**	(55)	**-**	-
Consideration received for businesses transferred to Westpac New Zealand	**-**	-	**154**	-
Net cash (used in)/provided by investing activities	**(2,972)**	(4,182)	**63**	(1,025)
Cash flows from financing activities				
Net increase/(decrease) in deposits	**3,815**	1,555	**371**	(865)
Net (decrease)/increase from debt issues	**(4,716)**	2,191	**-**	-
Net increase/(decrease) in due to related entities	**1,185**	(75)	**1,101**	285
Net decrease in subordinated debentures	**(73)**	(34)	**(73)**	(34)
Dividends paid on convertible debentures	**(100)**	(100)	**(100)**	(100)
Dividends paid to minority shareholders	**(4)**	(2)	**-**	-
Net cash provided by/(used in) financing activities	**107**	3,535	**1,299**	(714)
Net increase/(decrease) in cash and cash equivalents	**30**	980	**(70)**	(309)
Cash and cash equivalents at beginning of the year	**1,792**	812	**(22)**	287
Cash and cash equivalents at end of the year	**1,822**	1,792	**(92)**	(22)
Cash and cash equivalents at end of the year comprise:				
Cash and balances with central banks	**1,714**	1,871	**119**	514
Cash and balances with central banks (discontinued operations)	**-**	-	**-**	142
Due from/(to) other financial institutions (net)	**108**	(79)	**(211)**	(531)
Due to other financial institutions (discontinued operations)	**-**	-	**-**	(147)
	1,822	1,792	**(92)**	(22)
Reconciliation of profit after income tax expense to net cash provided by/(used in) operating activities				
Profit after income tax expense	**759**	666	**196**	267
Adjustments:				
Impairment charges/(recoveries) on loans	**184**	226	**(5)**	2
Computer software amortisation costs	**38**	42	**-**	-
Depreciation on property, plant and equipment	**28**	22	**-**	-
Gain on disposal of property, plant and equipment	**-**	(7)	**-**	-
Loss on disposal of computer software	**-**	2	**-**	-
Share-based payments	**7**	18	**1**	3
Movement in other assets	**(108)**	4	**(58)**	(7)
Movement in other liabilities	**(10)**	15	**19**	-
Movement in current and deferred tax	**55**	132	**16**	19
Tax on cash flow hedge reserve	**(16)**	(20)	**-**	-
Tax on available-for-sale securities reserve	**(11)**	-	**-**	-
Tax on convertible debentures dividends	**28**	30	**28**	30
Tax losses transferred from related entities	**-**	-	**15**	24
Movement in trading securities	**1,706**	(185)	**(1,473)**	489
Movement in trading liabilities	**(768)**	1,047	**(768)**	1,047
Movement in derivative financial instruments	**1,003**	(365)	**597**	(444)
Net cash provided by/(used in) operating activities	**2,895**	1,627	**(1,432)**	1,430

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

Notes to the financial statements

Note 1 Statement of accounting policies

1.1 General accounting policies

Statutory base

These financial statements have been prepared and presented in accordance with the Financial Reporting Act 1993, the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**') and the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 2) 2012 ('**Order**').

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

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

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

These financial statements are for the New Zealand Branch as a separate reporting entity and the consolidated financial statements are for the NZ Banking Group.

These financial statements were authorised for issue by the Board on 20 December 2012. The Board has the power to amend the financial statements after they are authorised for issue.

Basis of preparation

The financial statements are based on the general principles of historical cost accounting, as modified by the fair value accounting for available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss and all financial derivative contracts. The going concern concept and the accruals basis of accounting have been adopted. All amounts in these financial statements have been rounded in millions of New Zealand dollars unless otherwise stated.

The same accounting policies and methods of computation have been followed in preparing these financial statements that were used in preparing the financial statements for the year ended 30 September 2011, except as amended for the changes required due to the adoption of the new and revised accounting standards as explained in Note 1.3 Changes in accounting policies.

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

Basis of aggregation

The NZ Banking Group as at 30 September 2012 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, Hastings Forestry Investments Limited and the consolidated capital and reserves of BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Westpac New Zealand Group Limited and their controlled entities. For New Zealand entities acquired by the Overseas Banking Group, capital and reserves at acquisition are netted and recognised as capital contributed to the NZ Banking Group.

The NZ Banking Group may invest in or establish special purpose vehicles to enable it to undertake specific types of transactions. Where the NZ Banking Group controls such entities, they are consolidated into the NZ Banking Group's financial results.

All transactions and balances between entities within the NZ Banking Group have been eliminated.

Foreign currency

Items included in the financial statements of each of the NZ Banking Group's entities are measured using the currency of the primary economic environment in which the entity operates ('**functional currency**'). The financial statements of the NZ Banking Group and the NZ Branch are presented in New Zealand dollars, which is the NZ Branch's functional and presentation currency.

Foreign currency monetary assets and liabilities have been translated into New Zealand dollars at the rate of foreign exchange prevailing as at reporting date. Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rates in effect at the date of the transaction.

Foreign exchange differences relating to monetary items, and gains and losses arising from foreign exchange dealings by the NZ Banking Group, have been included in the income statement, except where deferred in equity as qualifying cash flow hedges.

Note 1 Statement of accounting policies (continued)

1.2 Particular accounting policies

Revenue recognition

Interest income

Interest income for all interest earning financial assets, including those at fair value, is recognised in the income statement using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, cash flows are estimated based upon all contractual terms of the financial instrument (e.g. prepayment options), but do not consider future credit losses. The calculation includes all fees and other amounts 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.

Interest relating to impaired loans is recognised using the loan's original effective interest rate based on the net carrying value of the impaired loan after giving effect to impairment charges or for a variable rate loan, the current effective interest rate determined under the contract. This rate is also used to discount the future cash flows for the purpose of measuring the impairment charges. For loans that have been impaired, this method results in cash receipts being apportioned between interest and principal.

Leasing

Finance leases are accounted for under the net investment method whereby income recognition is based on a pattern reflecting a constant periodic rate of return on the net investment in the finance lease and is included as part of interest income.

Fee and commission income

Fees and commissions are generally recognised on an accruals basis over the period during which the service is performed. All fees relating to the successful origination or settlement of a loan (together with the related direct costs) are deferred and recognised as an adjustment to the effective interest rate on the loan.

Other dividend income

Dividends on quoted shares are recognised on the ex-dividend date. Dividends on unquoted shares are recognised when the company's right to receive payment is established.

Net trading income

Realised gains or losses, and unrealised gains or losses arising from changes in the fair value of the trading assets and liabilities, are recognised as trading income within non-interest income in the income statement in the period in which they arise, except for recognition of day-one profits or losses which are deferred where certain valuation inputs are unobservable. Dividend income on the trading portfolio is also recorded as part of non-interest income. Interest income or expense on the trading portfolio is recognised as part of net interest income.

Gain or loss on sale of property, plant and equipment

The gain or loss arising on the disposal or retirement of property, plant and equipment is determined as the difference between the sale proceeds less costs of disposal and the carrying amount of the respective asset and is recognised in the income statement as non-interest income.

Expense recognition

Interest expense

Interest expense, including premiums or discounts and associated expenses incurred on the issue of financial liabilities, is recognised in the income statement using the effective interest method.

Impairment charges on loans and receivables carried at amortised cost

The charge recognised in the income statement for impairment on loans and receivables carried at amortised cost reflects the net movement in the provisions for individually assessed and collectively assessed loans, write offs and recoveries of impairments previously written off.

Leasing

Operating lease payments are recognised in the income statement as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the benefit received. Incentives received on entering into operating leases are recognised as liabilities and amortised as a reduction of rental expense on a straight-line basis over the lease term.

Commissions and other fees

External commissions and other costs paid to acquire loans are capitalised and amortised using the effective interest method. All other fees and commissions are recognised in the income statement over the period in which the related service is received.

Life insurance acquisition costs

Deferred acquisition costs associated with the life insurance business are costs that are incremental to the acquisition of new business. These costs are recorded as an asset and are amortised in the income statement on the same basis as the recognition of related revenue.

Note 1 Statement of accounting policies (continued)

Share-based payment

Certain employees are entitled to participate in option and share ownership schemes granted by the Overseas Bank.

The fair value of performance options, performance share rights and unhurdled share rights provided to employees as share-based payments is recognised as an expense with a corresponding amount payable to the Overseas Bank. The fair value is measured at the grant date and is recognised over the period in which the services are received which is the expected vesting period during which the employees would become entitled to exercise the performance option, performance share right or unhurdled share right.

The fair value of performance options, performance share rights and unhurdled share rights is estimated at grant date using a Binomial/Monte Carlo simulation pricing model incorporating the vesting and performance hurdle features of the grants. The fair value of the performance options, performance share rights and unhurdled share rights excludes the impact of any non-market vesting conditions such as the participants' continued employment with the NZ Banking Group. The non-market vesting conditions are included in assumptions used when determining the number of performance options, performance share rights and unhurdled share rights expected to become exercisable for which an expense is recognised. As at each reporting date these assumptions are revised and the expense recognised in each year takes into account the most recent estimates.

Taxation

Income tax

Income tax expense on the profit for the year comprises current tax and movement in deferred tax balances.

Current tax is the expected tax payable on the taxable income for the financial year, using tax rates that have been enacted or substantively enacted as at the balance date, and any adjustment to tax payable in respect of previous years.

Deferred tax is accounted for using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding amounts used for taxation purposes. Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill, the initial recognition of assets and liabilities that affect neither accounting nor taxable profit (other than in a business combination), or differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates that have been enacted or substantively enacted as at the balance date that are expected to apply when the liability is settled or the asset is realised.

Current and deferred taxes attributable to amounts recognised in other comprehensive income are also recognised in other comprehensive income.

Except as noted above, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. For presentation purposes deferred tax assets and deferred tax liabilities have been offset where they relate to income taxes levied by the same taxation authority on the same taxable entity or group of entities in the NZ Banking Group.

Goods and services tax

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

Business combinations

External acquisitions

The acquisition method of accounting is used to account for external business combinations. Cost is measured as the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange. Acquisition-related costs are expensed as incurred. Where equity instruments are issued in an acquisition, the value of the instruments is their published market price as at the date of exchange. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

Identifiable assets acquired, and liabilities and contingent liabilities assumed, in a business combination are measured initially at their fair value at the acquisition date. For each business combination, the non-controlling interest is measured either at fair value or at the proportionate share of the acquiree's identifiable net assets. The excess of the cost of acquisition, the amount of any non-controlling interest in the acquiree, and the acquisition date fair value of any previous equity interest in the acquiree, over the fair value of the identifiable net assets acquired is recorded as goodwill.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the NZ Banking Group's incremental borrowing rate.

Common control transactions

The predecessor method of accounting is used to account for business combinations between entities in the NZ Banking Group.

Assets acquired and liabilities assumed in a common control transaction are measured initially at the acquisition date at the carrying value from the NZ Banking Group's perspective. The excess of cost of acquisition over the initial carrying values of the entity's share of the net assets acquired is recorded as part of a common control reserve.

Assets

Financial assets

The NZ Banking Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale securities. Management determines the classification of its financial assets at initial recognition.

Note 1 Statement of accounting policies (continued)

- ***Financial assets at fair value through profit or loss***

  This category has two sub-categories: first, financial assets held for trading and second, those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling it in the near term, if it is part of a portfolio of financial assets that are managed together and for which there is evidence of a recent pattern of short-term profit taking, if it is a derivative that is not a designated hedging instrument, or if so designated on acquisition by management. This designation may only be made if the financial asset contains an embedded derivative, it is managed on a fair value basis in accordance with a documented risk management strategy, or if designating it at fair value reduces an accounting mismatch.

- ***Loans and receivables***

  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the NZ Banking Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

- ***Available-for-sale securities***

  Available-for-sale securities are non-derivative financial assets that are designated as available-for-sale or that are not classified as either financial assets at fair value through profit or loss or loans and receivables.

  Other investments, which comprise unlisted equity securities that do not have a quoted price in an active market and where fair value cannot be estimated within a reasonable range of probable outcomes, are carried at cost.

Recognition and measurement of financial assets

Purchases and sales of financial assets at fair value through profit or loss and available-for-sale are recognised on the trade-date, the date on which the NZ Banking Group commits to purchase or sell the asset. Loans and receivables are recognised when cash is advanced to the borrower. Financial assets at fair value through profit or loss are recognised initially at fair value. All other financial assets are recognised initially at fair value plus directly attributable transaction costs.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortised cost using the effective interest method. Realised and unrealised gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in other comprehensive income until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the right to receive payment is established. Foreign exchange gains or losses and interest, calculated using the effective interest rate method, on available for sale debt instruments are also recognised in the income statement.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active, the NZ Banking Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Derecognition of financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the entity has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full, without material delay, to a third party under a 'pass-through' arrangement and cannot sell or re-pledge the asset other than to the transferee; and
- either the NZ Banking Group has transferred substantially all the risks and rewards of the asset, or the NZ Banking Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A situation may arise where the NZ Banking Group transfers its right to receive cash flows from an asset or has entered into a pass-through arrangement. In some cases the NZ Banking Group would have neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of these assets. Should this occur, to the extent that the NZ Banking Group has continuing involvement in the asset, the asset continues to be recognised on the balance sheet.

Cash and balances with central banks

Cash and balances with central banks include cash at branches, central bank settlement account balances and nostro balances. They are brought to account at the face value or the gross value of the outstanding balance, where appropriate. These balances have a maturity of less than three months.

Due from other financial institutions

Due from other financial institutions includes loans and settlement account balances due from other financial institutions. They are accounted for as loans and receivables and subsequently measured at amortised cost using the effective interest method.

Derivative financial instruments

Derivative financial instruments, including forwards, futures, swaps and options, are recognised in the balance sheet at fair value. Fair value is obtained from quoted market prices, independent dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Also included in the determination of the fair value of derivatives is a credit valuation adjustment ('**CVA**'). Where the derivative has a positive fair value (asset), this credit adjustment is to reflect the credit worthiness of the counterparty. Where the derivative has a negative fair value (liability), this credit adjustment reflects the NZ Banking Group's own credit risk. These credit adjustments are taken into account after considering any relevant collateral or master netting agreements.

Note 1 Statement of accounting policies (continued)

Trading securities

Trading securities include debt and equity instruments which are actively traded and securities purchased under an agreement to resell. They are accounted for as financial assets at fair value through profit or loss.

Certain bonds, notes and commercial bills are designated at fair value through profit or loss. This designation may only be made if the financial asset contains an embedded derivative, it is managed on a fair value basis in accordance with a documented risk management strategy, or if designating it at fair value reduces an accounting mismatch.

Available-for-sale securities

Available-for-sale securities are public and other debt and equity securities that are designated as available-for-sale or that are not classified as either financial assets at fair value through profit or loss or loans and receivables. The accounting policy for available-for-sale securities is set out above.

Loans

Loans include advances, overdrafts, housing loans, credit card and other personal lending, term loans and leasing. The accounting policy for loans and receivables is set out above.

Security is obtained if, based on an evaluation of the customer's creditworthiness, it is considered necessary for the customer's overall borrowing facility. Security would normally consist of assets such as cash deposits, receivables, inventory, plant and equipment, real estate or investments.

Loan products that have both a mortgage and deposit facility are presented on a gross basis in the balance sheet, segregating the loan and deposit component into the respective balance sheet line items. Interest earned on this product is presented on a net basis in the income statement as this reflects how the customer is charged.

Life insurance assets

Assets held by the NZ Banking Group's life insurance company, including investments in funds managed by the NZ Banking Group, are initially recorded at fair value and then adjusted to net market value as at each reporting date. Net market value adjustments are included in the income statement. The life insurance company's assets comprise the life insurance fund and can only be used within the restrictions imposed under the Insurance (Prudential Supervision) Act 2010. The main restriction is that the assets in the fund can only be used to meet the liabilities and expenses of the life insurance business of the life insurance company or as distributions when solvency requirements are met, and cannot be used to support any other business of the life insurance company.

Due from related entities

This amount includes amounts due from controlled entities of the NZ Banking Group and all other entities controlled by the Overseas Bank.

Impairment of financial assets

Impaired financial assets include:

- individually impaired assets, which are defined as assets where an individual provision has been raised to cover the expected loss for which full recovery of principal is doubtful; and
- restructured assets, which are defined as assets in which the original contractual terms have been formally modified to provide for concessions of interest or principal for reasons related to the financial difficulties of the customer.

Assets that are in arrears based upon their contractual terms, but not yet impaired, are reported separately as 'past due assets'.

Assets, not classified as impaired assets or past due assets, in which the counterparty is (a) in receivership, liquidation, bankruptcy, statutory management or any form of administration in New Zealand; or (b) in any other equivalent form of voluntary or involuntary administration in an overseas jurisdiction, are reported separately. These are known as 'other assets under administration'.

The following accounting policies apply to the impairment of financial assets:

i) Assets carried at amortised cost

The NZ Banking Group assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment charges are recognised if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a '**loss event**') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of financial assets is impaired includes observable data that comes to the attention of the NZ Banking Group about the following loss events:

(i) significant financial difficulty of the issuer or obligor;
(ii) a breach of contract, such as a default or delinquency in interest or principal payments;
(iii) the NZ Banking Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the NZ Banking Group would not otherwise consider;
(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
(v) the disappearance of an active market for that financial asset because of financial difficulties; or
(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the NZ Banking Group, including:
  (a) adverse changes in the payment status of borrowers in the NZ Banking Group; or
  (b) national or local economic conditions that correlate with defaults on the assets in the NZ Banking Group.

Note 1 Statement of accounting policies (continued)

The NZ Banking Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the NZ Banking Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment on loans and receivables has been incurred, the amount of the charge is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the NZ Banking Group's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows for a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the NZ Banking Group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets reflect, and are directionally consistent with, changes in related observable data from period to period (e.g. changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the NZ Banking Group to reduce any differences between loss estimates and actual loss experience. When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the charge for loan impairment in the income statement. If, in a subsequent period, the amount of the impairment charge decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment charge is reversed by adjusting the provision account. The amount of the reversal is recognised in the income statement.

ii) Available-for-sale

The NZ Banking Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt instruments classified as available-for-sale, impairment is determined using the same methodology as Note 1 – Impairment of financial assets (i) Assets carried at amortised cost. For equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment charge on that financial asset previously recognised in the income statement – is removed from other comprehensive income and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment charge was recognised in the income statement, the impairment charge is reversed through the income statement. Subsequent reversal of impairment charges on equity instruments is not recognised in the income statement.

Investments in controlled entities and associates

Investments in controlled entities are initially recorded by the NZ Banking Group in the balance sheet at cost. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Investments in controlled entities are written-down to their recoverable amount, where appropriate.

Associates are entities over which the NZ Banking Group has significant influence but not control. Investments in associates are accounted for in the parent entity financial statements using the cost method and in the consolidated financial statements using the equity method of accounting, after initially being recognised at cost.

The NZ Banking Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Dividends receivable from associates are recognised as dividend income in the parent entity's income statement, while in the consolidated financial statements they reduce the carrying amount of the investment.

Goodwill and other intangible assets

Goodwill represents amounts arising on the acquisition of businesses. Prior to the revised NZ IFRS 3 *Business Combinations* ('**NZ IFRS 3**'), goodwill represented the excess of purchase consideration, including directly attributable expenses associated with the acquisition, over the fair value of the NZ Banking Group's share of the identifiable net assets of the acquired business. Goodwill arising on the acquisition of a business subsequent to the adoption of the revised NZ IFRS 3 represents the excess of the purchase consideration, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree, over the acquisition date fair value of net identifiable assets acquired.

All goodwill is considered to have an indefinite life.

Note 1 Statement of accounting policies (continued)

Goodwill is tested for impairment annually and whenever there is an indication that it may be impaired, and is carried at cost less any accumulated impairment. Gains or losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Cash-generating units ('**CGU**') are the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Goodwill was last tested for impairment as at 30 September 2012 and no impairment has been recognised in the income statement.

Other intangible assets are stated at cost less accumulated amortisation and impairment. Other intangible assets consist of acquired and internally developed computer software.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Internal and external costs directly incurred in the purchase or development of computer software, including subsequent upgrades and enhancements, are recognised as intangible assets when it is probable that they will generate future economic benefits attributable to the NZ Banking Group. These assets (both acquired and internally developed computer software) are amortised using the straight-line method to allocate the cost of the asset less any residual value over their estimated useful lives of three years.

Property, plant and equipment

Property, plant and equipment is carried at cost less accumulated depreciation and impairment. Cost is the fair value of the consideration provided plus incidental costs directly attributable to the acquisition. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred. Impairment is recognised as an operating expense in the income statement.

Depreciation is calculated using the straight-line method to allocate the cost of assets less any residual value over their estimated useful lives as follows:

- Leasehold improvements   Up to 10 years
- Furniture and equipment   3 to 15 years

Other assets

Other assets include accrued interest receivable, trade debtors and prepayments.

Impairment of non-financial assets

The carrying amount of the NZ Banking Group's non-financial assets, other than deferred tax assets, are reviewed at each balance date to determine whether there is any indication of impairment. If such an indication exists, the asset's recoverable amount is estimated. An impairment is recognised whenever the carrying amount of an asset or the CGU to which it is allocated exceeds its recoverable amount. With the exception of goodwill (for which impairment charges are not reversed), where an impairment charge subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment charge been recognised for the asset (or CGU) in prior years. Impairment charges and reversals of impairment charges are recognised in the income statement.

The recoverable amount of an asset is the greater of its fair value less cost to sell and value-in-use. In assessing value-in-use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGU to which the asset belongs.

Liabilities

Financial liabilities

The NZ Banking Group classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and financial liabilities at amortised cost.

- ***Financial liabilities at fair value through profit or loss***

  This category has two sub-categories: first, financial liabilities held for trading and second, those designated at fair value through profit or loss at inception. A financial liability is classified in this category if incurred principally for repurchasing it in the near term, if it is part of a portfolio of financial liabilities that are managed together and for which there is evidence of a recent pattern of short-term profit taking, if it is a derivative that is not a designated hedging instrument, or if so designated on initial recognition by management. This designation may only be made if the financial liability contains an embedded derivative, it is managed on a fair value basis in accordance with a documented risk management strategy, or if designating it at fair value reduces an accounting mismatch.

- ***Financial liabilities at amortised cost***

  This category includes all financial liabilities other than those at fair value through profit or loss. Liabilities in this category are measured at amortised cost.

Note 1 Statement of accounting policies (continued)

Recognition and measurement of financial liabilities

Financial liabilities are initially recognised at fair value less transaction costs except where they are subsequently measured at fair value, in which case transaction costs are expensed as incurred. They are subsequently measured at amortised cost except for derivatives and liabilities at fair value, which are held at fair value through profit or loss. Financial liabilities are recognised when an obligation arises.

Derecognition of financial liabilities

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

Due to other financial institutions

Due to other financial institutions includes deposits, vostro balances and settlement account balances due to other financial institutions. They are measured at amortised cost.

Deposits at fair value

Deposits at fair value represent certificates of deposits. They are classified at fair value through profit or loss as they are managed as part of a trading portfolio.

Deposits at amortised cost

Deposits at amortised cost include non-interest bearing deposits repayable at call and interest bearing deposits. They are measured at amortised cost.

Derivative financial instruments

Derivative financial instruments, including forwards, futures, swaps and options, are recognised in the balance sheet at fair value. Fair values are obtained from quoted market prices, independent dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Also included in the determination of the fair value of derivatives is a CVA. Where the derivative has a positive fair value (asset), this credit adjustment is to reflect the credit worthiness of the counterparty. Where the derivative has a negative fair value (liability), this credit adjustment reflects the NZ Banking Group's own credit risk. These credit adjustments are taken into account after considering any relevant collateral or master netting agreements.

Trading liabilities

Securities sold under repurchase agreements and securities sold short are classified as trading liabilities. They are accounted for as financial liabilities at fair value through profit or loss.

Debt issues

Debt issues are bonds, notes and commercial paper that have been issued by the NZ Banking Group. They are either accounted for at amortised cost or at fair value through profit or loss. If the liability is accounted for at amortised cost it is initially recorded at cost, which is the fair value of the consideration received, net of transaction costs. Subsequently, the debt is measured using the effective interest method. If the liability is accounted for at fair value through profit or loss, the debt issue is initially recognised at the fair value of the consideration received. Debt issues are measured at fair value through profit or loss to reduce an accounting mismatch, which arises from associated derivatives being executed for risk management purposes.

Life insurance policy liabilities

Life insurance policy liabilities are calculated by using the margin on service methodology. Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each major product line using applied assumptions at each reporting date. Profit margins are released over each financial period in line with the service that has been provided. The balance of the planned profit is deferred by including it in the value of policy liabilities.

Financial guarantees

Financial guarantee contracts are recognised as financial liabilities at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of the amount determined in accordance with New Zealand International Accounting Standard ('**NZ IAS**') 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less cumulative amortisation, where appropriate.

The fair value of a financial guarantee contract is determined as the present value of the difference in net cash flows between the contractual payments under the debt instrument and the payments that would be required without the guarantee, or the estimated amount that would be payable to a third party for assuming the obligation.

Other liabilities

Other liabilities include accrued interest payable, securities purchased but not yet delivered, claims reserves on insurance policies, amounts outstanding on the credit card loyalty programme, trade creditors, other accrued expenses and the deficit arising from the defined benefit superannuation scheme.

Subordinated debentures

Subordinated debentures issued by the NZ Banking Group are initially recorded at cost, which is the fair value of the consideration received, net of transaction costs. They are subsequently measured at amortised cost using the effective interest method to amortise cost at inception to the redemption value over the expected life of the debt.

Note 1 Statement of accounting policies (continued)

Due to related entities

This amount includes amounts due to controlled entities of the NZ Banking Group and all other entities controlled by the Overseas Bank.

Employee entitlements

Wages and salaries, annual leave and sick leave

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the balance date are recognised as provisions in respect of employees' services up to the balance date and are measured at the amounts expected to be paid when the liabilities are settled.

No provision is made for non-vesting sick leave as the pattern of sick leave taken indicates that no additional liability will arise for non-vesting sick leave.

Long service leave

Liabilities for long service leave expected to be settled within 12 months of the balance date are recognised in the provision for long service leave and are measured at the amounts expected to be paid when the liabilities are settled.

Liabilities for long service leave and other deferred employee benefits expected to be settled more than 12 months from the balance date are recognised in the provision for long service leave and are measured at the present value of future payments expected to be made in respect of services provided by employees up to the balance date. Consideration is given to expected future wage and salary levels, experience of employee departure and periods of service. Expected future payments are discounted to their net present value using market yields at the balance date on government bonds with terms that match as closely as possible to the estimated timing of future cash flows.

Superannuation obligations

Obligations for contributions to the defined contribution superannuation scheme are recognised as an expense in the income statement as incurred.

The asset or liability recognised in the balance sheet in respect of the defined benefit superannuation scheme is the present value of the defined benefit obligation as at the reporting date less the fair value of the scheme's assets. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of government bonds that have terms to maturity approximating the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

The actuarial valuation of scheme obligations is dependent upon a series of assumptions, the key ones being price inflation, earnings growth, mortality, morbidity and investment returns assumptions. Different assumptions could significantly alter the amount of difference between scheme assets and obligations, and the superannuation cost charged to the income statement.

Actuarial gains and losses related to the defined benefit superannuation scheme are recorded directly in retained earnings. The net deficit within the scheme is recognised and disclosed separately in 'Other liabilities' as a retirement benefit deficit.

Termination benefits

Liabilities for termination benefits are recognised when a detailed plan for terminations has been developed (and is without realistic possibility of withdrawal) and a valid expectation has been raised in those employees affected that the terminations will be carried out. Liabilities for termination benefits are recognised within 'Other liabilities' unless the timing or amount is uncertain, in which case they are recognised as provisions.

Liabilities for termination benefits expected to be settled within 12 months are measured at amounts expected to be paid when they are settled. Amounts expected to be settled more than 12 months from the balance date are measured at the estimated cash outflows, discounted using market yields at the balance date on government bonds with terms to maturity that match, as closely as possible, the estimated future payments, where the effect of discounting is material.

Provisions

Non-lending losses

Non-lending losses are any losses that have not arisen as a consequence of an impaired credit decision. Those provisions include litigation and associated costs, frauds and the correction of operational issues. A provision is recognised where it is probable that there will be an outflow of economic resources.

Provision for impairment on credit commitments

Provision is made for losses incurred as a result of the commitment to extend credit.

Provision for restructuring

A provision for restructuring is recognised where there is a demonstrable commitment and a detailed plan such that there is little or no discretion to avoid payments to other parties and the amount can be reliably estimated.

Head office account and equity

Ordinary shares

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

Head office account - Branch capital

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

Note 1 Statement of accounting policies (continued)

Convertible debentures

Convertible debentures are recognised in the balance sheet at the amount of consideration received, net of issue costs.

Reserves

Available-for-sale securities reserve

The available-for-sale securities reserve comprises the changes in the fair value of available-for-sale securities, net of tax. These changes are recognised in the income statement as other income when the asset is either derecognised or impaired.

Cash flow hedge reserve

The cash flow hedge reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

Hedging

The NZ Banking Group uses derivative instruments as part of its asset and liability management activities to manage exposures to interest rate and foreign currency, including exposures arising from forecast transactions. The NZ Banking Group enters into derivative transactions that provide economic hedges for risk exposures, but do not meet the requirements for hedge accounting treatment. Gains and losses on these derivative transactions are recorded in the income statement. The NZ Banking Group also enters into derivative transactions that are designated and qualify as either fair value hedges or cash flow hedges for recognised assets and liabilities or forecast transactions. The method of recognising the fair value gain or loss on derivatives depends on the nature of the hedging relationship. Hedging relationships are of two types:

- fair value hedge: a hedge of the change in fair value of recognised assets or liabilities or unrecognised firm commitments; and
- cash flow hedge: a hedge of variability in highly probable future cash flows attributable to a recognised asset or liability, or a highly probable forecast transaction.

The NZ Banking Group uses hedge accounting for derivatives designated in this way when certain criteria are met. At the time a financial instrument is designated as a hedge, the NZ Banking Group formally documents the relationship between the hedging instrument and hedged item, together with the methods that will be used to assess the effectiveness of the hedging relationship. The NZ Banking Group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been highly effective in offsetting changes in the fair value or cash flows of the hedged items.

A hedge is regarded as highly effective if, at inception and throughout its life, the NZ Banking Group can expect changes in the fair value or cash flows of the hedged item to be almost fully offset by the changes in the fair value or cash flows of the hedging instrument, and actual results of the hedge are within a range of 80% to 125% of these changes. Hedge ineffectiveness represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item or the amount by which changes in the cash flows of the hedging derivative differ from changes (or expected changes) in the present value of the cash flows of the hedged item.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributed to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, any previous adjustment to the carrying amount of a hedged item recognised at amortised cost is amortised to the income statement over the period to maturity.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in other comprehensive income are transferred to the income statement in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, terminated or exercised, or when the hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in the period in which the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

Embedded derivatives

In certain instances a derivative may be embedded in a host contract. If the host contract is not carried at fair value through profit or loss, the embedded derivative is separated from the host contract and accounted for as a stand-alone derivative instrument at fair value where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Loan securitisation

The NZ Banking Group, through its loan securitisation programme, packages and sells loans (principally housing mortgage loans) as securities to investors. In such transactions, the NZ Banking Group provides an equitable interest in the loans to investors who provide funding to the NZ Banking Group. Securitised loans that do not qualify for derecognition and the associated funding are included in loans and debt issues respectively.

Note 1 Statement of accounting policies (continued)

Funds management activities

Certain controlled entities within the NZ Banking Group conduct investment management and other fiduciary activities as custodian or manager on behalf of individuals, trusts, superannuation schemes and other institutions. These activities involve the management of assets in unit trusts, group investment funds and superannuation schemes, and the holding or placing of assets on behalf of third parties.

Where controlled entities incur liabilities in respect of these activities, a right of indemnity exists against the assets of the applicable trusts. As these assets are sufficient to cover liabilities, and it is not probable that the controlled entities will be required to settle them, the liabilities are not included in the consolidated financial statements.

Leases

Leases are classified as either finance leases or operating leases. Under a finance lease, substantially all the risks and rewards incidental to legal ownership are transferred to the lessee. In contrast, an operating lease exists where the risks of the leased assets remain with the lessor.

In its capacity as a lessor, the NZ Banking Group primarily offers finance leases. The NZ Banking Group recognises the assets held under finance lease in the balance sheet as loans at an amount equal to the net investment in the lease. The recognition of finance income is based on a pattern reflecting a constant periodic return on the NZ Banking Group's net investment in the finance lease. Finance lease income is included within net interest income in the income statement.

In its capacity as a lessee, the NZ Banking Group mainly leases property, plant and equipment under operating leases. Payments due to the lessor under operating leases are charged to equipment and occupancy expense on a straight-line basis over the term of the lease.

Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The NZ Banking Group has determined that the NZ Banking Group executive team is its chief operating decision-maker.

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

Statement of cash flows

Basis of presentation

The statement of cash flows has been presented in accordance with NZ IAS 7 *Statement of Cash Flows* with netting of certain items as disclosed below.

Cash and cash equivalents

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management of the NZ Banking Group, which are readily convertible at the investor's or customer's option and include the interbank balances arising from the daily Reserve Bank of New Zealand ('**Reserve Bank**') settlement process.

Netting of cash flows

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

1.3 Changes in accounting policies

As a result of the new and revised accounting standards which became operative for the annual reporting period commencing 1 October 2011, the following standards, interpretations and amendments have been adopted with effect from 1 October 2011 in the preparation of these financial statements:

- NZ IFRS 7 *Financial Instruments: Disclosures* ('**NZ IFRS 7**'):
  - The amendments add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. In addition, certain disclosure requirements have been amended or removed.
  - *Amendments to NZ IFRS 7 Disclosures – Transfers of Financial Assets* – The amendments require additional disclosures about the transfer of financial assets, including in respect of the nature of the financial assets involved and the risks associated with them.
- NZ IAS 1 *Presentation of Financial Statements* – The amendments clarify that an analysis of other comprehensive income by item is required to be disclosed either in the statement of changes in equity or in the notes to the financial statements.
- NZ IAS 24 *Related Party Disclosures* – The main changes to the standard simplify the definition of a related party and clarify its intended meaning.
- NZ IAS 34 *Interim Financial Reporting* – The amendments add examples to the list of significant events or transactions that require disclosure under NZ IAS 34.

Note 1 Statement of accounting policies (continued)

- New Zealand Equivalent to International Financial Reporting Interpretations Committee ('**NZ IFRIC**') 13 *Customer Loyalty Programmes* – The amendments clarify the fair value of award credits and take into account the amount of discounts or incentives that otherwise would be offered to customers that have not earned the award credits.
- NZ IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* – The amendments remove the unintended consequence arising from the treatment of prepayments when there is a minimum funding requirement. These amendments result in prepayments of contributions in certain circumstances being recognised as an asset rather than an expense.
- *Amendments to NZ IFRS 7: Disclosure Amendments to Appendix E New Zealand-specific additional disclosure requirements applicable to financial institutions* – The amendments replace the term 'financial institutions' with the term 'deposit takers'. The amendments also remove registered banks from its scope as the disclosure requirements have been relocated to the Order.
- *Amendments to NZ IFRSs to Harmonise with IFRS and Australian Accounting Standards* – The amendments remove certain New Zealand-specific disclosures and relocate certain New Zealand-specific disclosure requirements to a new standard. The NZ Banking Group has chosen to continue disclosing certain information no longer required as a result of this joint Trans-Tasman Convergence project.
- Financial Reporting Standard 44 *New Zealand Additional Disclosures* – This is applicable only to New Zealand and is a consequence of the joint Trans-Tasman Convergence project of the Australian Accounting Standards Board and Financial Reporting Standards Board. This standard contains New Zealand specific disclosures that were previously located in other NZ IFRSs and also revises certain disclosures.

Adoption of these new and revised accounting standards has not resulted in any material change to the NZ Banking Group's reported result or financial position.

1.4 Future accounting developments

The following new standards, interpretations and amendments have been issued, but are not yet effective and have not been early adopted by the NZ Banking Group:

- *Disclosures – Offsetting Financial Assets and Financial Liabilities* (Amendments to NZ IFRS 7) was issued in February 2012 and will be effective to the NZ Banking Group in the 2014 financial year. The amendment requires disclosure of information that will enable users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with recognised financial assets and financial liabilities on the NZ Banking Group's balance sheet. The amendment is expected to result in additional disclosures.
- NZ IFRS 9 *Financial Instruments* – If this standard is not early adopted it will be effective for the 30 September 2016 financial year end. The major changes under the standard are that:
  - it replaces the multiple classification and measurement models in NZ IAS 39 *Financial Instruments: Recognition and Measurement* with a single model that has two classification categories: amortised cost and fair value;
  - a financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial assets for the collection of the contractual cash flows; and b) the contractual cash flows under the instrument solely represent the payment of principal and interest;
  - if a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch;
  - there will be no separation of an embedded derivative where the instrument is a financial asset;
  - equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present the fair value changes on an equity investment directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss, however, dividends from such investments will continue to be recognised in profit or loss; and
  - if an entity holds an investment in asset-backed securities it must determine the classification of that investment by looking through to the underlying assets and assess the credit quality of the investment compared with the underlying portfolio of assets. If an entity is unable to look through, then the investment must be measured at fair value.

  The reissued version of the standard in December 2010 included the requirements for classification and measurement of financial instruments, including both financial assets and financial liabilities, as well as recognition and derecognition requirements for financial instruments. The main additional change as a result of the reissued version relates to the measurement of financial liabilities. Specifically, the portion of a change of fair value relating to the entity's own credit risk for financial liabilities measured at fair value utilising the fair value option is presented in other comprehensive income, except when that would create an accounting mismatch. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in profit or loss.

  The standard will impact the classification and measurement of the NZ Banking Group's financial instruments.
- NZ IFRS 10 *Consolidated Financial Statements* ('**NZ IFRS 10**') and NZ IFRS 12 *Disclosure of Interests in Other Entities* ('**NZ IFRS 12**') – These new standards were issued in June 2011 and are applicable to the NZ Banking Group in the 2014 financial year. The new consolidation standard changes the definition of control and requires that it be applied to all entities to determine whether control exists. The new definition focuses on the need for both power and exposure to variability of returns in order for control to be present. The new disclosure standard increases the disclosure requirements for both consolidated and unconsolidated entities. The new standards are not expected to have a material impact on the NZ Banking Group.
- NZ IFRS 13 *Fair Value Measurement* ('**NZ IFRS 13**') - The new standard was issued in June 2011 and is applicable to the NZ Banking Group in the 2014 financial year. The new standard replaces existing guidance on fair value measurement in several standards with a single, unified definition of fair value and a framework for measuring and disclosing fair values. NZ IFRS 13 applies to all assets and liabilities measured at fair value, not just financial instruments. The new standard is not expected to have a material impact on the NZ Banking Group.

Note 1 Statement of accounting policies (continued)

- *Presentation of Items of Other Comprehensive Income* (Amendments to NZ IAS 1) – The amendments were issued in August 2011 and are applicable to the NZ Banking Group in the 2013 financial year. Under the amended standard, the format of other comprehensive income will need to be changed to separate items that might be recycled to net profit from items that will not be recycled. Items included in other comprehensive income that may be recycled into profit or loss in future periods include gains or losses on cash flow hedges. Those that will not be recycled include fair value changes on own credit risk for financial liabilities designated at fair value and defined benefits actuarial gains and losses. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 19 *Employee Benefits* ('**NZ IAS 19**') – The amendments were issued in August 2011 and are applicable to the NZ Banking Group in the 2014 financial year. The amendments require entities to account immediately, in retained earnings, for all estimated changes in the cost of providing these benefits and all changes in the value of plan assets (often referred to as the removal of the 'corridor amount'). The amendments also contain a new presentation approach that clearly distinguishes the different components of the cost of these benefits. Minimal impact is expected on the NZ Banking Group as a result of these changes as the NZ Banking Group's current accounting and presentation treatment is in line with the new amendments. Two areas of impact will be the change in the measurement of pension expense and additional disclosures to provide clearer information about the risks arising from defined benefit plans.
- NZ IAS 27 *Separate Financial Statements* – The amendments were issued in June 2011 and are applicable to the NZ Banking Group in the 2014 financial year. The amendments remove the accounting and disclosure requirements for consolidated financial statements as a result of the issuance of NZ IFRS 10. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 28 *Investments in Associates and Joint Ventures* – The standard was issued in June 2011 and is applicable to the NZ Banking Group in the 2014 financial year. This standard supersedes NZ IAS 28 *Investments in Associates* as a result of the issuance of NZ IFRS 12. It is not expected to have a material impact on the NZ Banking Group.
- *Offsetting Financial Assets and Financial Liabilities* (Amendments to NZ IAS 32 *Financial Instruments: Presentation* ('**NZ IAS 32**')) was issued in February 2012 and will be effective to the NZ Banking Group in the 2015 financial year. The amendment provides application guidance to addressing inconsistencies applied to offsetting criteria provided in NZ IAS 32, including clarifying the meaning of current legally enforceable rights of set-off and that some gross settlement systems may be considered as the equivalent to net settlement. The amendment is not expected to have a material impact on the NZ Banking Group.
- *Annual Improvements 2009 – 2011 Cycle* was issued in June 2012 and will be effective to the NZ Banking Group in the 2014 financial year. The amendments relate to the following:
  - NZ IAS 1 – clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative period is the previous period.
  - NZ IAS 32 – clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with NZ IAS 12 *Income Taxes*.
  - NZ IAS 34 – clarifies the requirements in NZ IAS 34 relating to segment information for total assets and liabilities for each reportable segment to enhance consistency with the requirements in NZ IFRS 8 *Operating Segments*.

  The amendments are not expected to have a material impact on the NZ Banking Group.

1.5 Critical accounting estimates, judgment and assumptions

The application of the NZ Banking Group's accounting policies necessarily requires the use of estimates, judgment and assumptions. Should different estimates, judgments or assumptions be applied, the resulting values would change, impacting the net assets and income of the NZ Banking Group and the NZ Branch.

Critical accounting estimates and assumptions

The nature of estimates and assumptions used and the value of the resulting asset and liability balances are included in the policies below.

Fair value of financial instruments

Financial instruments classified as held for trading or designated at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured and recognised at fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial market pricing models, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves, equities and commodities prices, option volatilities and currency rates. Most market parameters are either directly observable or are implied from instrument prices. Furthermore, profits or losses are recognised upon initial recognition only when such profits can be measured by reference to observable current market transactions or valuation techniques based on observable market inputs. In the event that inputs into valuation techniques are non-market observable, any day one profit or loss is amortised over the life of the transaction.

The calculation of fair value for any financial instrument may also require adjustment of the quoted price or model value to reflect the cost of credit risk (where not embedded in underlying models or prices used). The process of calculating fair value on illiquid instruments or from a valuation model may require estimation of certain pricing parameters, assumptions or model characteristics.

These estimates are calibrated against industry standards, economic models and observed transaction prices.

The fair value of financial instruments is provided in Note 28, as well as the mechanism by which fair value has been derived.

Note 1 Statement of accounting policies (continued)

A negligible proportion of the NZ Banking Group's trading derivatives are valued directly from quoted prices, the majority being valued using appropriate valuation techniques, using observable market inputs. The fair value of substantially all securities positions carried at fair value is determined directly from quoted prices or observable market inputs.

Provisions for impairment charges on loans and credit commitments

The NZ Banking Group's loan impairment provisions are established to recognise incurred impairment in its portfolio of loans. A loan is impaired when there is objective evidence that events occurring since the loan was recognised have affected expected cash flows from the loan.

The impairment charge is the difference between the carrying value of the loan and the present value of estimated future cash flows calculated at the loan's original effective interest rate for fixed rate loans and the loan's current effective interest rate for variable rate loans. Provisions for loan impairment represent management's estimate of the impairment charges incurred in the loan portfolios as at the balance date. Changes to the provisions for loan impairment and changes to the provisions for undrawn contractually committed facilities and guarantees provided are reported in the income statement as part of the impairment charges on loans.

There are two components to the NZ Banking Group's loan impairment provisions, individual and collective as follows:

(a) Individual component – all impaired loans that exceed specified thresholds are individually assessed for impairment. Individually assessed loans principally comprise the NZ Banking Group's portfolio of commercial loans to medium and large businesses. Impairment is recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held (discounted at the loan's original effective interest rate for fixed rate loans and the loan's current effective interest rate for variable rate loans). Relevant considerations that have a bearing on the expected future cash flows are taken into account, including the business prospects for the customer, the realisable value of collateral, the NZ Banking Group's position relative to other claimants, the reliability of customer information and the likely cost and duration of the work-out process. Subjective judgments are made in this process. Furthermore, judgments can change with time as new information becomes available or as work-out strategies evolve, resulting in revisions to the impairment provision as individual decisions are taken.

(b) Collective component – this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collective impaired loan provisions) and for loan impairments that have been incurred but have not been separately identified at the balance date (incurred but not reported provisions). These are established on a portfolio basis taking into account the level of arrears, collateral, past loss experience and defaults based on portfolio trends. The most significant factors in establishing these provisions are the estimated loss rates and the related emergence period. The emergence period for each loan product type is determined through detailed studies of loss emergence patterns. Loan files where losses have emerged are reviewed to identify the average time period between observable loss indicator events and the loss becoming identifiable. These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, unemployment levels, payment behaviour and bankruptcy rates.

The provisions for impairment on loans are disclosed in Notes 13 and 14, whilst the provisions for impairment on credit commitments are disclosed in Note 22. The impairment charge reflected in the income statement is disclosed in Note 7.

Goodwill

Goodwill represents amounts arising on the acquisition of businesses. Prior to the revised NZ IFRS 3 *Business Combinations*, goodwill represented the excess of purchase consideration, including directly attributable expenses associated with the acquisition, over the fair value of the NZ Banking Group's share of the identifiable net assets of the acquired business. Goodwill arising on the acquisition of a business subsequent to the adoption of the revised NZ IFRS 3 represents the excess of the purchase consideration, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree, over the acquisition date fair value of the NZ Banking Group's share of the identifiable net assets acquired.

The determination of the fair value of assets and liabilities of the acquired businesses requires the exercise of management judgment. Different fair values would result in changes to the goodwill balance and to the post-acquisition performance of the acquisition.

To determine if goodwill is impaired, the carrying value of the identified CGU to which the goodwill is allocated, including the allocated goodwill, is compared to its recoverable amount. Recoverable amount is the higher of the CGU's fair value less costs to sell and its value-in-use. Value-in-use is the present value of expected future cash flows from the CGU. Determination of appropriate cash flows and discount rates for the calculation of value-in-use is subjective. Fair value is the amount obtainable for the sale of the CGU in an arm's length transaction between knowledgeable and willing parties. The assumptions applied to determine if any impairment exists, along with the carrying amount of goodwill, are outlined in Note 15.

Note 1 Statement of accounting policies (continued)

Superannuation obligations

The NZ Banking Group operates a defined benefit superannuation scheme for staff in New Zealand. For this scheme, actuarial valuations of the scheme's obligations and the fair value measurements of the scheme's assets are performed annually in accordance with the requirements of NZ IAS 19.

The actuarial valuation of scheme obligations is dependent upon a series of assumptions, the key ones being price inflation, earnings growth, mortality, morbidity and investment returns assumptions. Different assumptions could significantly alter the amount of the difference between scheme assets and obligations, and the superannuation cost charged to the income statement.

The carrying amount and the primary assumptions used in the calculation of superannuation defined benefit obligation are disclosed in Notes 23 and 31.

Provisions (other than loan impairment losses)

Provisions are held in respect of a range of obligations such as employee entitlements, restructuring costs, litigation costs and non-lending losses, as disclosed in Note 22. Some of the provisions involve significant judgment about the likely outcome of various events and estimated future cash flows. Payments which are expected to be incurred after more than one year are discounted at a rate which reflects both current interest rates and the risks specific to that provision.

Critical accounting judgments

The judgments, apart from those involving estimations, that management has made in applying the NZ Banking Group's accounting policies and that have the most significant impact on the amounts recognised in the financial statements are as follows:

Income taxes

The NZ Banking Group is subject to income taxes in New Zealand and jurisdictions where it has foreign operations. Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax outcome is unclear. Provisions for tax are held to reflect these uncertainties.

The NZ Banking Group estimates its tax liabilities based on the NZ Banking Group's understanding of the tax law. Where the final outcome of these matters is different from the amounts initially recorded, such differences will impact the current and deferred tax provisions in the period when such determinations are made.

Securitisation and the consolidation of special purpose vehicles

The NZ Banking Group sponsors the formation of special purpose vehicles ('**SPV**') in the ordinary course of business, primarily to provide funding and financial services products to its customers. SPVs are typically set up for a single, pre-defined purpose, have a limited life and generally are not operating entities nor do they have employees. The most common form of SPV structure involves the acquisition of financial assets by the SPV that are funded by the issuance of securities to external investors (securitisation). Repayment of the securities is determined by the performance of the assets acquired by the SPV.

Under NZ GAAP, an SPV is consolidated and reported as part of the NZ Banking Group if it is controlled by the parent entity in line with NZ IAS 27 *Consolidated and Separate Financial Statements* or deemed to be controlled in applying New Zealand Standing Interpretations Committee 12 *Consolidation – Special Purpose Entities*. The definition of control is based on the substance rather than the legal form of the arrangement. As it can sometimes be difficult to determine whether the NZ Banking Group controls an SPV, management makes judgments about the NZ Banking Group's exposure to the associated risks and rewards, as well as its ability to make operational decisions for the SPV.

Note 2 Transfer of operations from NZ Branch to Westpac New Zealand

2.1 Background of transfer of operations from NZ Branch to Westpac New Zealand

Until 1 November 2006, the Overseas Bank conducted its operations in New Zealand through a branch structure. On that date, and after extensive consultation with the Reserve Bank, the Overseas Bank adopted a dual operating model including a locally incorporated subsidiary, Westpac New Zealand, to conduct its consumer and business banking operations in New Zealand, and a branch, Westpac Banking Corporation New Zealand Branch, to conduct its institutional and financial markets operations.

Following an independent review of the structure of the operating model of the Overseas Bank's business in New Zealand, the Reserve Bank, Westpac New Zealand and the Overseas Bank reached agreement on changes to the operating model. On 1 November 2011, assets and liabilities associated with certain business activities formerly conducted by the NZ Branch were transferred to Westpac New Zealand. The transfer occurred pursuant to the Westpac New Zealand Act 2011.

The following business activities were transferred from the NZ Branch to Westpac New Zealand:

- institutional customer deposits;
- institutional customer transactional banking;
- institutional customer lending (other than trade financing activities);
- debt capital markets activities carried out in assisting corporate customers to obtain funding, such as loan syndication and securitisation arrangements but excluding the debt securities team activities, such as arrangement of commercial paper and bond programmes;
- corporate advisory; and
- institutional customer foreign currency accounts.

Note 2 Transfer of operations from NZ Branch to Westpac New Zealand (continued)

The NZ Branch has retained:

- financial markets operations for external customers, including sales and trading of capital markets products and foreign exchange for corporate and institutional customers;
- pricing and risk management for interest rate, foreign exchange and commodity products for retail, business and institutional customers of Westpac New Zealand;
- trading of capital markets products and foreign exchange as principal;
- global intra-group financing functions;
- correspondent bank relationships;
- debt securities team activities, such as arrangement of commercial paper and bond programmes; and
- international business, including trade finance activities but excluding customer foreign currency accounts.

2.2 Accounting for the transfer of operations by the NZ Branch

The transfer of operations was accounted for by the NZ Branch as a discontinued operation in accordance with NZ IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* ('**NZ IFRS 5**'). A discontinued operation is a component of the NZ Branch's business that represents a separate major line of business that has been disposed of or is classified as held for sale, or is a subsidiary or business unit that has been disposed of or classified as held for sale.

In accordance with NZ IFRS 5, when an operation is classified as a discontinued operation, the comparative income statement is restated as if the operation had been discontinued from the start of the comparative period. No gain or loss on sale was recorded in the NZ Branch as the transaction was accounted for based on the carrying value of assets and liabilities transferred.

The transfer of operations from the NZ Branch to Westpac New Zealand had no impact on the NZ Banking Group as the NZ Branch and Westpac New Zealand both form part of the NZ Banking Group.

2.3 Assets and liabilities transferred from the NZ Branch to Westpac New Zealand

$ millions	Assets and Liabilities Transferred As at 1 November 2011
Assets	
Cash and balances with central banks	58
Loans	6,336
Deferred tax assets	28
Other assets	24
Total assets	6,446
Liabilities	
Due to other financial institutions	212
Deposits	5,060
Provisions	12
Other liabilities	19
Total liabilities	5,303
Net assets transferred	1,143

Contingent liabilities and commitments transferred from the NZ Branch to Westpac New Zealand

$ millions	As at 1 November 2011
Contingent liabilities and commitments	
Transaction-related contingent items	421
Short-term, self-liquidating trade-related contingent liabilities	107
Other commitments to provide financial services	6,464
Total contingent liabilities and commitments	6,992

Consideration received for the businesses transferred from the NZ Branch to Westpac New Zealand

$ millions	As at 1 November 2011
Consideration received	
Intragroup receivable	3,100
Trading securities	(1,957)
Total consideration received	1,143

Note 2 Transfer of operations from NZ Branch to Westpac New Zealand (continued)

The notes to the financial statements show the total financial results of continuing and discontinued operations. An analysis by continuing and discontinued operations for profit after income tax expense for the years ended 30 September 2012 and 30 September 2011, and total assets and total liabilities as at 30 September 2011, are disclosed below.

2.4 Analysis of profit after income tax expense from continuing and discontinued operations

		NZ Branch		
$ millions	Note	**Continuing Operations**	**Discontinued Operations**	**Total**
For the year ended 30 September 2012				
Net interest income	3	**158**	**16**	**174**
Non-interest income				
Fees and commissions	4	**15**	**4**	**19**
Trading income	4	**118**	**-**	**118**
Other non-interest income	4	**7**	**-**	**7**
Total non-interest income		**140**	**4**	**144**
Net operating income		**298**	**20**	**318**
Operating expenses	5	**(49)**	**(2)**	**(51)**
Impairment recoveries on loans	7	**3**	**2**	**5**
Profit before income tax expense		**252**	**20**	**272**
Income tax expense on operating profit	8	**(71)**	**(5)**	**(76)**
Profit after income tax expense		**181**	**15**	**196**

		NZ Branch		
$ millions	Note	Continuing Operations	Discontinued Operations	Total
For the year ended 30 September 2011				
Net interest income	3	142	133	275
Non-interest income				
Fees and commissions	4	15	33	48
Trading Income	4	96	-	96
Other non-interest expense	4	(7)	-	(7)
Total non-interest income		104	33	137
Net operating income		246	166	412
Operating expenses	5	(45)	(16)	(61)
Impairment charges on loans	7	(1)	(1)	(2)
Profit before income tax expense		200	149	349
Income tax expense on operating profit	8	(73)	(35)	(108)
Income tax related to New Zealand structured finance transactions	8	26	-	26
Profit after income tax expense		153	114	267

Note 2 Transfer of operations from NZ Branch to Westpac New Zealand (continued)

Assets and liabilities of continuing and discontinued operations as at 30 September 2011

		NZ Branch 2011		
$ millions	Note	Continuing Operations	Discontinued Operations	Total
Assets				
Cash and balances with central banks		514	142	656
Derivative financial instruments		5,976	-	5,976
Trading securities		2,803	-	2,803
Loans	13	401	6,386	6,787
Due from related entities		6,429	-	6,429
Goodwill and other intangible assets		2	-	2
Deferred tax assets	16	9	29	38
Other assets	17	283	25	308
Total assets		16,417	6,582	22,999
Liabilities				
Due to other financial institutions	18	531	147	678
Deposits	19	-	4,689	4,689
Derivative financial instruments		5,364	-	5,364
Trading liabilities		1,286	-	1,286
Current tax liabilities		7	6	13
Provisions	22	4	14	18
Other liabilities	23	625	15	640
Subordinated debentures		785	-	785
Due to related entities		6,853	-	6,853
Total liabilities		15,455	4,871	20,326

Cash flows attributable to discontinued operations

	NZ Branch	
$ millions	**2012**	2011
For the year ended 30 September		
Net cash flow provided by operating activities	**11**	111
Net cash provided by/(used in) investing activities	**52**	(46)
Net cash (used in)/provided by financing activities	**(147)**	106

2.5 Accounting for the transfer of operation by Westpac New Zealand

The transfer of operations was accounted for by Westpac New Zealand as a business combination under common control.

Funding of acquisition

To fund the purchase of the assets and liabilities relating to the business activities transferred from the NZ Branch (as well as the additional liquid assets required to be held by Westpac New Zealand and its controlled entities as a result of the transfer), a loan of $3.1 billion was provided to Westpac New Zealand by the NZ Branch.

The loan is for a period of 3 years and has been priced at BKBM plus a margin that reflected market pricing on 1 November 2011.

Compliance with BS13 requirements (unaudited)

As a result of the transfer of the business activities set out above, Westpac New Zealand is required to hold additional liquid assets in order to comply with the Reserve Bank document *Liquidity Policy* (BS13). These liquid assets were acquired through a combination of on market purchases and a purchase of liquid assets from the NZ Branch. Westpac New Zealand was compliant with BS13 immediately following the transfer on 1 November 2011.

Impact on Westpac New Zealand

The impact of the transfer of operations on Westpac New Zealand is disclosed in Note 2 included in Westpac New Zealand's 30 September 2012 Disclosure Statement.

Note 3 Net interest income

$ millions	NZ Banking Group Year Ended 30-Sep-12	NZ Banking Group Year Ended 30-Sep-11	NZ Branch Year Ended 30-Sep-12	NZ Branch Year Ended 30-Sep-11
Interest income				
Cash and balances with central banks	**31**	31	**3**	20
Due from other financial institutions	**4**	3	**2**	3
Trading securities	**158**	197	**64**	95
Available-for-sale securities	**104**	26	**-**	-
Loans	**3,617**	3,701	**56**	357
Impaired assets	**51**	58	**-**	7
Due from related entities[1]	**-**	-	**237**	91
Total interest income[2]	**3,965**	4,016	**362**	573
Interest expense				
Due to other financial institutions	**8**	14	**6**	14
Deposits	**1,376**	1,417	**12**	194
Trading liabilities	**3**	10	**3**	10
Debt issues	**392**	395	**-**	-
Subordinated debentures	**35**	35	**35**	35
Other[3]	**626**	611	**132**	45
Total interest expense[4]	**2,440**	2,482	**188**	298
Net interest income	**1,525**	1,534	**174**	275

1 Included in interest income – due from related entities for the year ended 30 September 2012 was interest income of $125 million (30 September 2011: nil) on related entity borrowings in relation to the transfer of additional banking operations.

2 Total interest income for financial assets that were not at fair value through profit or loss was $3,807 million (30 September 2011: $3,819 million) for the NZ Banking Group and $298 million (30 September 2011: $478 million) for the NZ Branch.

3 Includes net interest expense due to/(due from) related entities and the net impact of Treasury balance sheet management activities.

4 Total interest expense for financial liabilities that were not at fair value through profit or loss was $2,272 million (30 September 2011: $1,943 million) for the NZ Banking Group and $185 million (30 September 2011: $288 million) for the NZ Branch.

For the year ended 30 September 2012 the NZ Banking Group had no material loans and deposits that were subject to set-off agreements (30 September 2011: nil).

In the current year, the presentation of interest income and interest expense relating to certain related entity transactions has been revised to better reflect the net impact of the underlying transactions. To improve presentation, comparative figures have been revised for interest income – trading securities for NZ Banking Group (2011: $197 million) and NZ Branch (2011: $95 million) respectively and interest income – due from related entities for NZ Branch (2011: $91 million) and interest expense – trading liabilities for NZ Banking Group (2011: $10 million), interest expense – other for NZ Banking Group (2011: $611 million) and NZ Branch (2011: $45 million) respectively. The revised presentation has no impact on total net interest income for the year ended 30 September 2011.

Note 4 Non-interest income

$ millions	NZ Banking Group Year Ended 30-Sep-12	NZ Banking Group Year Ended 30-Sep-11	NZ Branch Year Ended 30-Sep-12	NZ Branch Year Ended 30-Sep-11
Fees and commissions				
Transaction fees and commissions	**244**	238	**14**	27
Lending fees (loan and risk)	**61**	62	**4**	7
Insurance commissions received	**15**	12	**-**	-
Other non-risk fee income	**1**	7	**1**	14
Total fees and commissions	**321**	319	**19**	48
Wealth management revenue				
Fees from trust and other fiduciary activities	**153**	133	**-**	-
Net life insurance income and change in policy liabilities	**(32)**	(43)	**-**	-
Total wealth management revenue	**121**	90	**-**	-
Trading income				
Foreign exchange trading	**85**	76	**85**	76
Interest rate trading	**31**	18	**33**	20
Total trading income	**116**	94	**118**	96
Net ineffectiveness on qualifying hedges	**1**	3	**-**	-
Other non-interest income				
Net gains/(losses) on derivatives held for risk management purposes	**6**	(12)	**6**	(8)
Dividend income	**2**	3	**-**	-
Rental income	**1**	1	**-**	-
Gain on disposal of property, plant and equipment	**-**	7	**-**	-
Other	**14**	4	**1**	1
Total other non-interest income/(expense)	**23**	3	**7**	(7)
Total non-interest income	**582**	509	**144**	137

In the current year, the presentation of certain derivatives has been revised to better reflect the nature of the underlying transactions. To improve presentation comparative figures have been revised for interest rate trading for the NZ Banking Group (2011: $18 million) and NZ Branch (2011: $20 million) and net gains/(losses) on derivatives held for risk management purposes for NZ Banking Group (2011: loss of $12 million) and NZ Branch (2011: loss of $8 million) respectively. The revised presentation has no impact on total non-interest income for the year ended 30 September 2011.

Note 5 Operating expenses

$ millions	NZ Banking Group Year Ended 30-Sep-12	NZ Banking Group Year Ended 30-Sep-11	NZ Branch Year Ended 30-Sep-12	NZ Branch Year Ended 30-Sep-11
Salaries and other staff expenses				
Salaries and wages	**388**	369	**25**	30
Employee entitlements	**12**	10	**-**	-
Superannuation costs:				
Defined contribution scheme	**28**	26	**2**	2
Share-based payments	**7**	18	**1**	3
Restructuring costs	**4**	3	**-**	-
Other	**7**	10	**-**	1
Total salaries and other staff expenses	**446**	436	**28**	36
Equipment and occupancy expenses				
Operating lease rentals	**63**	61	**1**	1
Depreciation:				
Leasehold improvements	**16**	10	**-**	-
Furniture and equipment	**12**	12	**-**	-
Equipment repairs and maintenance	**9**	7	**-**	-
Electricity, water and rates	**2**	2	**-**	-
Other	**6**	6	**-**	-
Total equipment and occupancy expenses	**108**	98	**1**	1
Other expenses				
Software amortisation costs	**38**	42	**-**	-
Non-lending losses	**3**	2	**-**	-
Consultancy fees and other professional services	**78**	84	**6**	7
Auditors' remuneration (refer to Note 6)	**3**	3	**1**	1
Stationery	**13**	13	**-**	-
Postage and freight	**19**	19	**1**	1
Telecommunication costs	**1**	1	**1**	1
Advertising	**28**	28	**-**	-
Training	**4**	4	**-**	-
Travel	**11**	12	**1**	1
Outsourcing	**95**	82	**2**	2
Related entities – management fees	**13**	14	**10**	10
Other	**12**	7	**-**	1
Total other expenses	**318**	311	**22**	24
Total operating expenses	**872**	845	**51**	61

Note 6 Auditors' remuneration

$'000s	NZ Banking Group Year Ended 30-Sep-12	NZ Banking Group Year Ended 30-Sep-11	NZ Branch Year Ended 30-Sep-12	NZ Branch Year Ended 30-Sep-11
Auditor of the parent entity				
Audit and review of financial report	**1,641**	1,651	**519**	484
Other audit related work[1]	**331**	276	**165**	138
Other assurance services[2]	**278**	366	**-**	-
Total audit and other assurance services	**2,250**	2,293	**684**	622
Taxation compliance and advice	**55**	88	**15**	25
Other services[3]	**267**	318	**-**	-
Total non-audit fees	**322**	406	**15**	25
Total remuneration for audit and non-audit services	**2,572**	2,699	**699**	647

1 Sarbanes-Oxley reporting to the Overseas Banking Group.
2 Primarily assurance provided on certain financial information, including the issue of comfort letters in relation to debt issuance programmes.
3 Assurance and advisory services relating to other regulatory and compliance matters.

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

Notes to the financial statements

Note 6 Auditors' remuneration (continued)

The external auditors also provide audit and non-audit services to non-consolidated entities, including non-consolidated trusts of which the NZ Banking Group is manager or responsible entity and non-consolidated superannuation funds or pension funds. During the year ended 30 September 2012, the fees in respect of these services were approximately $719,000 (30 September 2011: $626,000).

All amounts disclosed above are GST exclusive.

Note 7 Impairment charges on loans

	NZ Banking Group				NZ Branch			
	For the year ended 30 September 2012				For the year ended 30 September 2012			
$ millions	**Residential Mortgages**	**Other Loans for Consumer Purposes**	**Loans for Business Purposes**	**Total**	**Residential Mortgages**	**Other Loans for Consumer Purposes**	**Loans for Business Purposes**	**Total**
Collectively assessed provisions	**(5)**	**(6)**	**(60)**	**(71)**	**-**	**-**	**(3)**	**(3)**
Individually assessed provisions	**23**	**-**	**190**	**213**	**-**	**-**	**(2)**	**(2)**
Bad debts written-off directly to the income statement	**2**	**43**	**29**	**74**	**-**	**-**	**-**	**-**
Interest adjustments	**(4)**	**(10)**	**(18)**	**(32)**	**-**	**-**	**-**	**-**
Total impairment charges/(recoveries) on loans	**16**	**27**	**141**	**184**	**-**	**-**	**(5)**	**(5)**

	NZ Banking Group				NZ Branch			
	For the year ended 30 September 2011				For the year ended 30 September 2011			
$ millions	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total
Collectively assessed provisions	(14)	(35)	(30)	(79)	-	-	3	3
Individually assessed provisions	80	-	191	271	-	-	4	4
Bad debts written-off directly to the income statement	5	44	23	72	-	-	-	-
Interest adjustments	(6)	(12)	(20)	(38)	-	-	(5)	(5)
Total impairment charges/(recoveries) on loans	65	(3)	164	226	-	-	2	2

Note 8 Income tax expense

	NZ Banking Group		NZ Branch	
$ millions	**Year Ended 30 September 2012**	Year Ended 30 September 2011	**Year Ended 30 September 2012**	Year Ended 30 September 2011
Income tax expense				
Current tax:				
Current year:				
– On operating profit	**274**	228	**77**	103
– New Zealand structured finance transactions	**-**	19	**-**	(26)
Prior year adjustments	**2**	(6)	**2**	-
Deferred tax (refer to Note 16):				
Current year – impact of change in tax rate	**-**	9	**-**	2
Current year – other	**18**	55	**(1)**	2
Prior year adjustments	**(1)**	2	**(2)**	1
Total income tax expense	**293**	307	**76**	82
Profit before income tax expense	**1,052**	973	**272**	349
Tax calculated at tax rate of 28% (2011: 30%)	**295**	292	**76**	105
Impact of change in tax rate on deferred tax	**-**	9	**-**	2
Income not subject to tax	**(3)**	(11)	**-**	-
Expenses not deductible for tax purposes	**-**	3	**-**	1
New Zealand structured finance transactions	**-**	19	**-**	(26)
Prior year adjustments	**1**	(4)	**-**	-
Other items	**-**	(1)	**-**	-
Total income tax expense	**293**	307	**76**	82
Total income tax expense comprises:				
Income tax expense on operating profit	**293**	288	**76**	108
Income tax expense/(benefit) related to New Zealand structured finance transactions	**-**	19	**-**	(26)
Total income tax expense	**293**	307	**76**	82

Note 8 Income tax expense (continued)

In May 2010 the New Zealand Government enacted a reduction in company tax rates from 30% to 28%, which applied to the NZ Branch and NZ Banking Group from 1 October 2011. Accordingly, the deferred taxes were remeasured at 28% to the extent that the underlying temporary differences were expected to reverse from 1 October 2011 onwards. As a result of this change in tax rate, the NZ Banking Group and NZ Branch recorded additional deferred tax expense of $9 million and $2 million respectively in the income statement for the year ended 30 September 2011.

Note 9 Imputation credit account

	NZ Banking Group		NZ Branch	
$ millions	**Year Ended 30-Sep-12**	Year Ended 30-Sep-11	**Year Ended 30-Sep-12**	Year Ended 30-Sep-11
Balance at beginning of the year	**1,671**	1,569	**518**	559
Transfers	**(13)**	(61)	**647**	(50)
Imputation credits attached to dividends received	**1**	2	**-**	-
Imputation credits attached to dividends paid	**(250)**	(1)	**(248)**	-
Income tax payments	**342**	162	**198**	9
Balance at end of the year	**1,751**	1,671	**1,115**	518

The NZ Branch and Westpac New Zealand formed an imputation group with effect from 1 April 2012.

Note 10 Due from other financial institutions

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Loans and advances to other banks	**322**	699	**-**	-
Total due from other financial institutions	**322**	699	**-**	-
Due from other financial institutions:				
At call	**-**	670	**-**	-
Term	**322**	29	**-**	-
Total due from other financial institutions	**322**	699	**-**	-
Amounts expected to be recovered within 12 months	**322**	699	**-**	-
Amounts expected to be recovered after 12 months	**-**	-	**-**	-
Total due from other financial institutions	**322**	699	**-**	-

Note 11 Trading securities

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Trading securities				
NZ corporate securities:				
Certificates of deposit	**2,172**	2,157	**623**	150
Corporate bonds	**484**	353	**112**	133
Mortgage-backed securities	**5**	7	**5**	7
NZ Government securities	**819**	2,858	**700**	1,823
Offshore securities	**4**	3	**4**	3
Securities purchased under agreement to resell	**544**	687	**544**	687
Total trading securities	**4,028**	6,065	**1,988**	2,803
Amounts expected to be recovered within 12 months	**3,731**	3,498	**1,988**	455
Amounts expected to be recovered after 12 months	**297**	2,567	**-**	2,348
Total trading securities	**4,028**	6,065	**1,988**	2,803

As at 30 September 2012 the NZ Banking Group and the NZ Branch had $12 million and $416 million (30 September 2011: $507 million and $507 million) of trading securities, respectively that were encumbered through repurchase agreements as part of standard terms of transactions with other banks.

Note 12 Available-for-sale securities

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
NZ Government securities	**2,154**	1,302	**-**	-
NZ debt securities	**56**	-	**-**	-
Overseas debt securities	**414**	166	**-**	-
Overseas equity securities	**70**	50	**-**	-
Total available-for-sale securities	**2,694**	1,518	**-**	-
Amounts expected to be recovered within 12 months	**26**	61	**-**	-
Amounts expected to be recovered after 12 months	**2,668**	1,457	**-**	-
Total available-for-sale securities	**2,694**	1,518	**-**	-

As at 30 September 2012 no available-for-sale securities were pledged as collateral for the NZ Banking Group's liabilities (30 September 2011: nil).

Note 13 Loans

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Overdrafts	**1,460**	1,258	**-**	313
Credit card outstandings	**1,311**	1,270	**-**	-
Money market loans	**1,165**	1,082	**-**	511
Term loans:				
Housing	**35,963**	35,044	**-**	-
Non-housing	**19,798**	19,163	**25**	5,413
Other	**802**	962	**361**	643
Total gross loans	**60,499**	58,779	**386**	6,880
Provisions for impairment charges on loans	**(607)**	(665)	**(1)**	(93)
Total net loans	**59,892**	58,114	**385**	6,787
Amounts expected to be recovered within 12 months	**7,892**	13,355	**196**	6,711
Amounts expected to be recovered after 12 months	**52,000**	44,759	**189**	76
Total net loans	**59,892**	58,114	**385**	6,787

As at 30 September 2012, $3.1 billion of housing loans are used by the NZ Banking Group to secure the obligations of Westpac Securities NZ Limited ('**WSNZL**') under Westpac New Zealand's Global Covered Bond Programme ('**CB Programme**') (30 September 2011: $2.5 billion). These housing loans were not derecognised from Westpac New Zealand's balance sheet in accordance with the accounting polices outlined in Note 1 (refer to Note 26 for details of the CB Programme). As at 30 September 2012, the New Zealand dollar equivalent of bonds issued by WSNZL under the CB Programme was $2.0 billion (30 September 2011: $1.8 billion).

The repurchase cash amount of the NZ Banking Group's repurchase agreements with the Reserve Bank using residential mortgage-backed securities issued by Westpac NZ Securitisation Limited ('**WNZSL**') as at 30 September 2012 was nil (30 September 2011: nil), with no underlying securities (30 September 2011: nil) provided under the arrangement.

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

Note 14 Credit quality, impaired assets and provisions for impairment charges on loans

	NZ Banking Group				NZ Branch			
	2012				2012			
$ millions	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total
Neither past due nor impaired	34,710	1,660	21,502	57,872	-	-	385	385
Past due assets								
Less than 30 days past due	917	105	348	1,370	-	-	-	-
At least 30 days but less than 60 days past due	99	20	13	132	-	-	-	-
At least 60 days but less than 90 days past due	48	10	15	73	-	-	-	-
At least 90 days past due	65	15	104	184	-	-	-	-
Total past due assets[1]	1,129	150	480	1,759	-	-	-	-
Individually impaired assets[2]								
Balance at beginning of the year	196	-	723	919	-	-	125	125
Additions	201	-	389	590	-	-	-	-
Amounts written off	(51)	-	(195)	(246)	-	-	(6)	(6)
Individually impaired assets transferred relating to discontinued activities	-	-	-	-	-	-	(118)	(118)
Returned to performing or repaid	(222)	-	(173)	(395)	-	-	-	-
Balance at end of the year	124	-	744	868	-	-	1	1
Total gross loans[3]	35,963	1,810	22,726	60,499	-	-	386	386
Individually assessed provisions								
Balance at beginning of the year	64	-	202	266	-	-	43	43
Impairment charges on loans:				-				
New provisions	59	-	217	276	-	-	-	-
Recoveries	(17)	-	(9)	(26)	-	-	-	-
Reversal of previously recognised impairment charges on loans	(19)	-	(18)	(37)	-	-	(2)	(2)
Amounts written off	(49)	-	(160)	(209)	-	-	-	-
Interest adjustments	-	-	7	7	-	-	(1)	(1)
Individually assessed provisions transferred relating to discontinued activities	-	-	-	-	-	-	(40)	(40)
Balance at end of the year	38	-	239	277	-	-	-	-
Collectively assessed provisions								
Balance at beginning of the year	66	69	302	437	-	-	62	62
Impairment charges on loans	(5)	(6)	(60)	(71)	-	-	(3)	(3)
Collectively assessed provisions transferred relating to discontinued activities	-	-	-	-	-	-	(57)	(57)
Balance at end of the year	61	63	242	366	-	-	2	2
Total provisions for impairment charges on loans and credit commitments	99	63	481	643	-	-	2	2
Provision for credit commitments (refer to Note 22)	-	-	(36)	(36)	-	-	(1)	(1)
Total provisions for impairment charges on loans	99	63	445	607	-	-	1	1
Total net loans	35,864	1,747	22,281	59,892	-	-	385	385

1 Past due assets are not impaired assets.
2 The NZ Banking Group had undrawn balances of $14 million on individually impaired assets under loans for business purposes as at 30 September 2012. The NZ Branch had no undrawn balances on individually impaired assets under loans for business purposes as at 30 September 2012.
3 The NZ Branch and NZ Banking Group did not have other assets under administration as at 30 September 2012.

Note 14 Credit quality, impaired assets and provisions for impairment charges on loans (continued)

	NZ Banking Group				NZ Branch			
	2011				2011			
$ millions	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total	Residential Mortgages	Other Loans for Consumer Purposes	Loans for Business Purposes	Total
Neither past due nor impaired	33,654	1,618	20,676	55,948	-	-	6,707	6,707
Past due assets								
Less than 30 days past due	933	96	371	1,400	-	-	48	48
At least 30 days but less than 60 days past due	114	19	42	175	-	-	-	-
At least 60 days but less than 90 days past due	52	10	19	81	-	-	-	-
At least 90 days past due	95	16	145	256	-	-	-	-
Total past due assets[1]	1,194	141	577	1,912	-	-	48	48
Individually impaired assets[2]								
Balance at beginning of the year	302	-	588	890	-	-	148	148
Additions	317	-	500	817	-	-	3	3
Amounts written off	(103)	-	(295)	(398)	-	-	(18)	(18)
Returned to performing or repaid	(320)	-	(70)	(390)	-	-	(8)	(8)
Balance at end of the year	196	-	723	919	-	-	125	125
Total gross loans[3]	35,044	1,759	21,976	58,779	-	-	6,880	6,880
Individually assessed provisions								
Balance at beginning of the year	80	-	276	356	-	-	54	54
Impairment charges on loans:								
New provisions	110	-	207	317	-	-	4	4
Recoveries	(20)	-	(10)	(30)	-	-	-	-
Reversal of previously recognised impairment charges on loans	(10)	-	(6)	(16)	-	-	-	-
Amounts written off	(98)	-	(272)	(370)	-	-	(18)	(18)
Interest adjustments	2		7	9	-	-	3	3
Balance at end of the year	64	-	202	266	-	-	43	43
Collectively assessed provisions								
Balance at beginning of the year	80	104	332	516	-	-	59	59
Impairment charges on loans	(14)	(35)	(30)	(79)	-	-	3	3
Balance at end of the year	66	69	302	437	-	-	62	62
Total provisions for impairment charges on loans and credit commitments	130	69	504	703	-	-	105	105
Provision for credit commitments (refer to Note 22)	-	-	(38)	(38)	-	-	(12)	(12)
Total provisions for impairment charges on loans	130	69	466	665	-	-	93	93
Total net loans	34,914	1,690	21,510	58,114	-	-	6,787	6,787

1 Past due assets are not impaired assets.
2 The NZ Branch and NZ Banking Group had undrawn balances of $5 million and $11 million respectively on individually impaired assets under loans for business purposes as at 30 September 2011.
3 The NZ Branch and NZ Banking Group did not have other assets under administration as at 30 September 2011.

Note 15 Goodwill and other intangible assets

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
Goodwill				
Cost	**547**	547	**-**	-
Accumulated impairment	**(22)**	(22)	**-**	-
Net carrying amount of goodwill	**525**	525	**-**	-
Computer software				
Cost	**389**	316	**7**	2
Accumulated amortisation and impairment	**(262)**	(224)	**(1)**	-
Net carrying amount of computer software	**127**	92	**6**	2
Total goodwill and other intangible assets	**652**	617	**6**	2

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

The recoverable amount of CGUs is determined annually based on value-in-use calculations, and was last performed at 30 September 2012. These calculations used discounted cash flow projections based on an approved two-year strategic business plan. While the strategic business plan assumes certain economic conditions, the forecast is not reliant on one particular assumption. These business forecasts applied by management are considered appropriate as they are based on past experience and are consistent with observable current market information. The growth rates after 2014 are assumed to be zero for all CGUs for the purpose of goodwill impairment testing. The discount rate used is the before tax equivalent of the NZ Banking Group's cost of capital of 15.3% as at 30 September 2012 (30 September 2011: 15.3%).

A reasonably possible change in these key assumptions would not cause the CGUs' carrying amount to exceed their recoverable amounts.

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

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
Retail banking	**512**	512	**-**	-
Wealth	**13**	13	**-**	-
Net carrying amount of goodwill	**525**	525	**-**	-

Note 16 Deferred tax assets

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
Deferred tax assets are attributable to the following:				
Property, plant and equipment	**12**	7	**2**	-
Provisions for impairment charges on loans	**181**	197	**1**	30
Provision for employee entitlements	**30**	27	**1**	1
Life insurance policy liabilities	**(20)**	(13)	**-**	-
Other temporary differences	**(7)**	(10)	**6**	7
Cash flow hedges	**13**	23	**-**	-
Balance at end of the year	**209**	231	**10**	38
To be recovered within 12 months	**166**	151	**3**	32
To be recovered after more than 12 months	**43**	80	**7**	6
Balance at end of the year	**209**	231	**10**	38
The deferred tax charge in income tax expense comprises the following temporary differences:				
Property, plant and equipment	**5**	-	**2**	-
Provision for impairment charges on loans	**(16)**	(58)	**(1)**	(3)
Provision for employee entitlements	**(4)**	1	**-**	-
Other temporary differences	**(2)**	(9)	**2**	(2)
Total deferred tax charge	**(17)**	(66)	**3**	(5)
Deferred tax transferred	**-**	-	**(28)**	-
Other	**1**	-	**(3)**	-
Total deferred tax charge – Other	**1**	-	**(31)**	-
The deferred tax charge in equity comprises the following temporary differences:				
Cash flow hedges	**(10)**	(20)	**-**	-
Provision for employee entitlements	**7**	5	**-**	-
Other	**(3)**	-	**-**	-
Total deferred tax charge	**(6)**	(15)	**-**	-

As at 30 September 2012 the aggregate temporary difference associated with investments in subsidiaries for which deferred tax liabilities have not been recognised were nil (30 September 2011: nil).

Note 17 Other assets

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Accrued interest receivable	**150**	138	**-**	25
Securities sold not yet delivered	**83**	265	**83**	265
Trade debtors and prepayments	**109**	31	**57**	1
Other	**42**	24	**22**	17
Total other assets	**384**	458	**162**	308
Amounts expected to be recovered within 12 months	**384**	458	**162**	308
Amounts expected to be recovered after 12 months	**-**	-	**-**	-
Total other assets	**384**	458	**162**	308

Included in accrued interest receivable of the NZ Banking Group were balances that amounted to $5 million (30 September 2011: $4 million) which related to accrued interest on housing loans sold to a special purpose entity under the CB Programme (refer to Note 26 for details of the CB Programme).

Note 18 Due to other financial institutions

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Interest bearing	**209**	755	**206**	655
Non-interest bearing, repayable at call	**5**	23	**5**	23
Total due to other financial institutions	**214**	778	**211**	678
Due to other financial institutions:				
At call	**154**	658	**151**	558
Term	**60**	120	**60**	120
Total due to other financial institutions	**214**	778	**211**	678
Amounts expected to be settled within 12 months	**214**	778	**211**	678
Amounts expected to be settled after 12 months	**-**	-	**-**	-
Total due to other financial institutions	**214**	778	**211**	678

Note 19 Deposits

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Deposits at fair value				
Certificates of deposit	**1,423**	1,556	**-**	-
Total deposits at fair value	**1,423**	1,556	**-**	-
Deposits at amortised cost				
Non-interest bearing, repayable at call	**2,969**	2,753	**-**	54
Other interest bearing:				
At call	**15,931**	14,386	**-**	2,983
Term	**23,067**	20,880	**-**	1,652
Total deposits at amortised cost	**41,967**	38,019	**-**	4,689
Total deposits	**43,390**	39,575	**-**	4,689
Amounts expected to be settled within 12 months	**41,385**	37,664	**-**	4,689
Amounts expected to be settled after 12 months	**2,005**	1,911	**-**	-
Total deposits	**43,390**	39,575	**-**	4,689

The NZ Branch held no retail deposits from individuals as at 30 September 2012 (30 September 2011: nil).

Note 20 Trading liabilities

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
Held for trading				
Securities sold short	**506**	779	**506**	779
Securities sold under agreements to repurchase	**12**	507	**12**	507
Total trading liabilities	**518**	1,286	**518**	1,286
Amounts expected to be settled within 12 months	**518**	1,286	**518**	1,286
Amounts expected to be settled after 12 months	**-**	-	**-**	-
Total trading liabilities	**518**	1,286	**518**	1,286

Note 21 Debt issues

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
Short-term debt				
Commercial paper	**4,033**	7,229	**-**	-
Total short-term debt	**4,033**	7,229	**-**	-
Long-term debt				
Non-domestic medium-term notes	**6,207**	8,803	**-**	-
Domestic medium-term notes	**2,674**	1,598	**-**	-
Total long-term debt	**8,881**	10,401	**-**	-
Total debt issues	**12,914**	17,630	**-**	-
Debt issues at amortised cost	**8,851**	9,903	**-**	-
Debt issues at fair value	**4,063**	7,727	**-**	-
Total debt issues	**12,914**	17,630	**-**	-
Movement in debt issues				
Balance at beginning of the year	**17,630**	15,439	**-**	-
Issuance during the year	**12,589**	17,788	**-**	-
Repayments during the year	**(16,196)**	(15,120)	**-**	-
Effect of foreign exchange movements during the year	**(1,188)**	(534)	**-**	-
Effect of fair value movements during the year	**79**	57	**-**	-
Balance at end of the year	**12,914**	17,630	**-**	-
Amounts expected to be settled within 12 months	**5,284**	9,992	**-**	-
Amounts expected to be settled after 12 months	**7,630**	7,638	**-**	-
Total debt issues	**12,914**	17,630	**-**	-

As at 30 September 2012, the NZ Banking Group had New Zealand Government guaranteed debt of $1,970 million on issue (30 September 2011: $4,073 million). For further information on New Zealand Government guaranteed debt please refer to Guarantee arrangements in Westpac New Zealand's disclosure statement for the year ended 30 September 2012.

Note 22 Provisions

$ millions	Long Service Leave	Annual Leave and Other Staff Benefits	Non-lending Losses	Impairment on Credit Commitments	Restructuring	Total
NZ Banking Group						
For the year ended 30 September 2012						
Balance as at 1 October 2011	**9**	**43**	**2**	**38**	**-**	**92**
Additional provisions recognised	**1**	**38**	**3**	**-**	**-**	**42**
Utilised during the year	**(3)**	**(30)**	**(3)**	**(2)**	**-**	**(38)**
Balance as at 30 September 2012	**7**	**51**	**2**	**36**	**-**	**96**
For the year ended 30 September 2011						
Balance as at 1 October 2010	9	46	1	42	4	102
Additional provisions recognised	1	19	2	-	-	22
Utilised during the year	(1)	(22)	(1)	(4)	(4)	(32)
Balance as at 30 September 2011	9	43	2	38	-	92
NZ Branch						
For the year ended 30 September 2012						
Balance as at 1 October 2011	**1**	**5**	**-**	**12**	**-**	**18**
Additional provisions recognised	**-**	**7**	**-**	**-**	**-**	**7**
Utilised during the year	**-**	**(3)**	**-**	**(11)**	**-**	**(14)**
Balance as at 30 September 2012	**1**	**9**	**-**	**1**	**-**	**11**
For the year ended 30 September 2011						
Balance as at 1 October 2010	1	9	-	13	4	27
Additional provisions recognised	-	4	-	-	-	4
Utilised during the year	-	(8)	-	(1)	(4)	(13)
Balance as at 30 September 2011	1	5	-	12	-	18

Provisions represent costs the NZ Banking Group and the NZ Branch expect to incur as a result of past events, where the timing of payment is uncertain. Provisions expected to be utilised beyond 12 months as at 30 September 2012 are $43 million (30 September 2011: $47 million) for the NZ Banking Group and $2 million for the NZ Branch (30 September 2011: $13 million).

Note 23 Other liabilities

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Accrued interest payable	**343**	339	**5**	14
Securities purchased but not yet delivered	**91**	604	**91**	604
Claims reserves	**14**	13	**-**	-
Credit card loyalty programme	**31**	30	**-**	-
Retirement benefit deficit	**77**	57	**-**	-
Trade creditors and other accrued expenses	**110**	100	**24**	18
Other	**55**	80	**2**	4
Total other liabilities	**721**	1,223	**122**	640
Amounts expected to be settled within 12 months	**644**	1,142	**122**	640
Amounts expected to be settled after 12 months	**77**	81	**-**	-
Total other liabilities	**721**	1,223	**122**	640

Note 24 Subordinated debentures

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Subordinated debentures	**712**	785	**712**	785

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

The subordinated convertible debentures are unsecured obligations of the NZ Branch and rank subordinate and junior in the right of payment of principal and distributions to certain of the NZ Branch's obligations to its depositors and creditors, including other subordinated creditors, other than subordinated creditors holding subordinated indebtedness that ranks equally with, or junior to, the holders of subordinated convertible debentures.

The subordinated convertible debentures will pay semi-annual distributions (31 March and 30 September) in arrears at the annual rate of 5.256% up to, but excluding, 31 March 2016. From, and including, 31 March 2016 the subordinated convertible debentures will pay quarterly distributions (31 December, 31 March, 30 June and 30 September) in arrears at a floating rate equal to London InterBank Offer Rate ('**LIBOR**') plus 1.7675% per annum. The subordinated convertible debentures will only pay distributions to the extent they are declared by the Board, or an authorised committee of the Board. Any distribution is subject to the Overseas Bank having sufficient distributable profits unless approved by the Australian Prudential Regulation Authority ('**APRA**'). If certain other conditions exist a distribution is not permitted to be declared.

The subordinated convertible debentures have no stated maturity but will automatically convert into American Depositary Receipts ('**ADRs**'), each representing 40 Overseas Bank preference shares (non-cumulative preference shares with a liquidation amount of US$25 per share) on 31 March 2053, or earlier in the event that a distribution is not made or certain other events occur. The holders of the ADRs will, in certain circumstances, have the right to convert their Overseas Bank preference shares into a variable number of Overseas Bank ordinary shares on 31 March 2054 by giving notice to the Overseas Bank.

With the prior written consent of APRA, if required, the Overseas Bank may elect to redeem the subordinated convertible debentures for cash before 31 March 2016, in whole, upon the occurrence of certain specific events, and in whole or in part on any distribution date on or after 31 March 2016. The holders of the subordinated convertible debentures do not have the option to require redemption of these instruments.

Note 25 Convertible debentures

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Convertible debentures	**1,284**	1,284	**1,284**	1,284

On 13 August 2003 the NZ Branch issued $1,284 million (net of issue costs) of junior subordinated convertible debentures to the trustee of the Tavarua Funding Trust III ('**Funding Trust III**'), being a member of the Overseas Banking Group. The investment by Funding Trust III in the convertible debentures was ultimately funded by the proceeds (net of issue costs) of approximately US$750 million of Trust Preferred Securities issued by the Overseas Banking Group in the United States of America.

The convertible debentures are unsecured obligations of the NZ Branch and rank subordinate and junior in the right of payment of principal and distributions to certain of the NZ Branch's obligations to its depositors and creditors, including other subordinated creditors, other than subordinated creditors holding subordinated indebtedness that ranks equally with, or junior to, the holders of convertible debentures.

The convertible debentures will pay semi-annual distributions (31 March and 30 September) in arrears at the annual rate of 7.57% up to but excluding 30 September 2013. From, and including, 30 September 2013 the convertible debentures will pay quarterly distributions (31 December, 31 March, 30 June and 30 September) in arrears at a floating rate equal to the New Zealand Bank Bill Rate plus 2.20% per annum. The convertible debentures will only pay distributions to the extent they are declared by the Board, or an authorised committee of the Board. Any distribution is subject to the Overseas Bank having sufficient distributable profits unless approved by APRA. If certain other conditions exist a distribution is not permitted to be declared.

The convertible debentures have no stated maturity, but will automatically convert into ADRs each representing 40 Overseas Bank preference shares (non-cumulative preference shares with a liquidation amount of US$25 per share) on 30 September 2053, or earlier in the event that a distribution is not made or certain other events occur.

Under the terms of the convertible debentures, the NZ Branch will make distributions in New Zealand dollars to Funding Trust III. Funding Trust III has entered into a currency swap with the Overseas Bank under which Funding Trust III has agreed to pay the Overseas Bank the New Zealand dollar distributions it receives on the convertible debentures in exchange for US dollars. The NZ Branch has also entered into a netting agreement under which it has agreed to pay any New Zealand dollar distributions on the convertible debentures direct to the Overseas Bank.

With the prior written consent of APRA, if required, the NZ Branch may elect to redeem the convertible debentures for cash before 30 September 2013 in whole upon the occurrence of certain specific events, and in whole or in part on any distribution date on or after 30 September 2013. The holders of the convertible debentures do not have an option to require redemption of these instruments.

Note 26 Related entities

NZ Banking Group

The NZ Banking Group consists of the New Zealand operations of the Overseas Banking Group including the NZ Branch and the following controlled entities as at 30 September 2012 whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business:

Name of Entity	Principal Activity	Notes
BT Financial Group (NZ) Limited	Holding company	
BT Funds Management (NZ) Limited	Funds management company	
Hastings Forestry Investments Limited	Non-trading company	
Westpac Financial Services Group-NZ-Limited	Holding company	
Westpac Life-NZ- Limited	Life insurance company	
Westpac Nominees-NZ-Limited	Nominee company	
HLT Custodian Trust	Custodian entity	
MIF Custodian Trust	Custodian entity	
Westpac Superannuation Nominees-NZ-Limited	Nominee company	
Westpac Group Investment-NZ-Limited	Holding company	
Westpac Holdings-NZ-Limited	Holding company	
Westpac Capital-NZ-Limited	Finance company	
Westpac Equity Investments NZ Limited	Finance company	
Westpac New Zealand Group Limited	Holding company	
Westpac New Zealand Limited	Registered bank	
Westpac NZ Operations Limited	Holding company	
Aotearoa Financial Services Limited[1]	Non-trading company	
Number 120 Limited	Finance company	
The Home Mortgage Company Limited	Residential mortgage company	
The Warehouse Financial Services Limited	Financial services company	51% owned
Westpac NZ Covered Bond Holdings Limited	Holding company	19% owned[2]
Westpac NZ Covered Bond Limited	Guarantor	19% owned[2]
Westpac (NZ) Investments Limited	Property leasing company	
Westpac NZ Leasing Limited	Finance company	Incorporated 6 September 2011[3]
Westpac NZ Securitisation Holdings Limited	Holding company	19% owned[4]
Westpac NZ Securitisation Limited	Funding company	19% owned[4]
Westpac Securities NZ Limited	Funding company	
Westpac Term PIE Fund	Portfolio investment entity	Not owned. Controlled by contractual arrangement

1 On 30 June 2011, Westpac NZ Operations Limited ('**WNZO**') acquired 100% of the shares issued by Aotearoa Financial Services Limited ('**AFS**') from Westpac Capital-NZ-Limited (a wholly-owned subsidiary of the Ultimate Parent Bank). AFS is a non-trading company. The transfer did not have a significant impact on the NZ Banking Group's financial position and results of operations.

2 Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**') and its wholly-owned subsidiary company, Westpac NZ Covered Bond Limited ('**WNZCBL**'), were incorporated on 22 November 2010. The NZ Banking Group, through its subsidiaries, WNZO (9.5%) and Westpac Holdings-NZ-Limited (9.5%), has a total qualifying interest of 19% in WNZCBHL. Westpac New Zealand is considered to control both WNZCBHL and WNZCBL based on contractual arrangements put in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the NZ Banking Group.

3 Westpac NZ Leasing Limited ('**WNZLL**') was incorporated on 6 September 2011. WNZLL did not have a significant impact on the NZ Banking Group's financial position as at 30 September 2011 and 2012 or the results of operations for the years ended 30 September 2011 and 2012.

4 Westpac NZ Securitisation Holdings Limited ('**WNZSHL**') and its wholly-owned subsidiary company, WNZSL, were incorporated on 14 October 2008. The NZ Banking Group, through its subsidiaries, WNZO (9.5%) and Westpac Holdings-NZ-Limited (9.5%), has a total qualifying interest of 19% in WNZSHL. Westpac New Zealand is considered to control both WNZSHL and WNZSL based on contractual arrangements put in place, and as such both WNZSHL and WNZSL are consolidated within the financial statements of the NZ Banking Group.

All entities in the NZ Banking Group are 100% owned unless otherwise stated. All entities within the NZ Banking Group have a reporting date of 30 September except Westpac Term PIE Fund ('**Term PIE**') which has a reporting date of 31 March. All entities within the NZ Banking Group are incorporated and domiciled in New Zealand.

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

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

Note 26 Related entities (continued)

The following entities ceased to be controlled entities of the NZ Banking Group during the year ended 30 September 2012. These entities had no material impact on the results of the NZ Banking Group for the year ended 30 September 2012.

Name of Entity	Notes	Date Struck Off NZ Companies Office Register
TBNZ Investments (UK) Limited	Company liquidated on 27 December 2011	4 January 2012
St. George New Zealand Limited	Company ceased to carry on business	20 July 2012

Investment in associate

Westpac New Zealand holds 18.8% (30 September 2011: 15%) of Cards NZ Limited's equity plus one Visa Inc access preference share issued by Cards NZ Limited. Cards NZ Limited has a balance date of 30 September.

The NZ Banking Group has on issue a promissory note to Cards NZ Limited in relation to the purchase of Visa Inc shares. The promissory note bears interest at market rates and will be defeased through an in-kind distribution upon liquidation of Cards NZ Limited.

Nature of transactions

The NZ Banking Group has transactions with members of the Overseas Banking Group on commercial terms, including the provision of management and administrative services and data processing facilities. Such transactions are not considered to be material either individually or in aggregate.

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

Transactions with the Overseas Bank

Management fees are paid by the NZ Branch to the Overseas Bank for management and administration services (consisting of salaries and other head office expenses) provided by the Overseas Bank. The total amount charged by the Overseas Bank for the year ended 30 September 2012 was $7 million (30 September 2011: $8 million).

The Overseas Bank provides funding to the NZ Branch. Interest is paid on this funding at market rates.

The NZ Banking Group receives funding from the London branch of the Overseas Bank on an as needs basis.

During the year ended 30 September 2012 the Overseas Bank transferred the cost of software developed to process international money transfers to the NZ Branch, including $4 million of capitalised intangible assets (30 September 2011: nil) and $3 million of expenses (30 September 2011: nil).

Transactions with controlled entities of the NZ Banking Group

The NZ Branch provides financial market services, foreign currency, trade and interest rate risk products to the customers of Westpac New Zealand. Westpac New Zealand receives commission from these sales. Commission received for the year ended 30 September 2012 was $4 million (30 September 2011: $4 million).

The NZ Branch provides loans to members of the NZ Banking Group. Interest paid on these loans is at market rates.

The NZ Branch and other entities within the NZ Banking Group provide banking facilities to funds managed by the NZ Banking Group on normal commercial terms.

WNZCBL is a special purpose entity established to purchase from time to time, and hold, housing loans ('**cover pool**') and to provide a financial guarantee (in addition to that of Westpac New Zealand) in respect of obligations under the covered bonds issued from time to time by WSNZL under the CB Programme. That financial guarantee is supported by WNZCBL granting security in favour of the covered bondholders over the cover pool.

The initial cover pool comprised housing loans with a value of $2.75 billion, the purchase of which was funded by an intercompany loan made by Westpac New Zealand to WNZCBL. The amount of the cover pool was increased to $3.75 billion in March 2012. The housing loans purchased by WNZCBL were not derecognised from Westpac New Zealand's financial statements (and therefore Westpac New Zealand and the NZ Banking Group records these housing loans) in accordance with the accounting policies outlined in Note 1. For this reason, Westpac New Zealand recognises a liability owed to WNZCBL (in the form of a 'deemed loan' from WNZCBL) of an amount equivalent to the sum of the value of the housing loans, cash and unpaid accrued interest arising from, and in respect of, the housing loans and the asset performance fee, and is included in Westpac New Zealand's 'Due to related entities'. The intercompany loan made by Westpac New Zealand to WNZCBL to fund the initial purchase (and subsequent further purchase which increased the cover pool) is included in Westpac New Zealand's 'Due from related entities'.

Over time, the composition of the cover pool will include, in addition to housing loans, cash (representing collections of principal and interest from the underlying housing loans) and accrued interest (representing accrued and unpaid interest on the outstanding housing loans). As at 30 September 2012, the assets of WNZCBL were $3.76 billion (30 September 2011: $2.76 billion), comprising housing loans, accrued interest and cash.

Refer to Note 13 Loans and Note 17 Other assets for the amounts of housing loans and accrued interest receivable, respectively, relating to the assets securing the obligations of WSNZL under the CB Programme. Refer to Note 29 Commitments and contingent liabilities for a description of the NZ Banking Group's obligation to repurchase housing loans sold to WNZCBL.

All loans sold by Westpac New Zealand to WNZSL and WNZCBL are legally owned by WNZSL and WNZCBL, respectively, and therefore Westpac New Zealand does not have any right to sell or grant security over those loans.

Note 26 Related entities (continued)

Transactions with associates

In 2008, the NZ Banking Group purchased Visa Inc shares from Cards NZ Limited at fair value totalling $48 million. The purchase was satisfied through the issue of an interest bearing promissory note. $1 million interest was paid on the promissory note during the year ended 30 September 2012 (30 September 2011: $1 million).

Transactions with other controlled entities of the Overseas Bank

The NZ Branch enters into derivative transactions with other members of the Overseas Banking Group, including the NZ Banking Group, in the normal course of business. These transactions are subject to a market standard netting agreement and, as a result, outstanding derivative balances are included in the due from related entities balance on a net basis. Management systems and operational controls are in place in order to manage any resulting interest rate or currency risk. Accordingly, it is not envisaged that any liability resulting in material loss will arise from these transactions.

Due from and to related entities

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Due from related entities				
Overseas Bank	**2,006**	2,272	**2,006**	2,269
Controlled entities of the NZ Banking Group	**-**	-	**7,679**	4,160
Total due from related entities	**2,006**	2,272	**9,685**	6,429
Amounts expected to be recovered within 12 months	**2,006**	2,272	**5,470**	5,974
Amounts expected to be recovered after 12 months	**-**	-	**4,215**	455
Total due from related entities	**2,006**	2,272	**9,685**	6,429
Due to related entities				
Overseas Bank	**7,774**	6,641	**5,663**	4,356
Controlled entities of the NZ Banking Group	**-**	-	**2,245**	2,494
Other controlled entities of the Overseas Bank	**62**	3	**62**	3
Associates of the NZ Banking Group	**48**	48	**-**	-
Total due to related entities	**7,884**	6,692	**7,970**	6,853
Amounts expected to be settled within 12 months	**5,957**	3,612	**7,020**	5,888
Amounts expected to be settled after 12 months	**1,927**	3,080	**950**	965
Total due to related entities	**7,884**	6,692	**7,970**	6,853
Total liabilities excluding subordinated debentures and due to related entities	**63,743**	66,055	**6,372**	12,688

At 30 September 2012, NZ Branch has revised its presentation of Due from related entities – Controlled entities of the NZ Banking Group and Due to related entities – Controlled entities of the NZ Banking Group. To improve presentation comparative information for NZ Branch Due from related entities – Controlled entities of the NZ Banking Group (2011: $4,160 million) and Due to related entities – Controlled entities of the NZ Banking Group (2011: $2,494 million) has been revised. The revised presentation has no impact on NZ Branch's net assets as at 30 September 2011.

Other group investments

The NZ Banking Group had significant non-controlling shareholdings in the following New Zealand based entities as at 30 September 2012:

Name	Shares Held by	Beneficial Interest	Nature of Business
Mondex New Zealand Limited	Westpac Holdings-NZ-Limited	20%	Smart card operations
Paymark Limited	Westpac NZ Operations Limited	25%	Electronic payments processing
Interchange and Settlement Limited	Westpac NZ Operations Limited	14%	Retail payments processing
Payments NZ Limited	Westpac New Zealand Limited	23%	Payments system

The NZ Banking Group does not have significant influence over these entities and therefore they are not classified as associates.

The total carrying amount of the NZ Banking Group's significant non-controlling shareholdings in the above investments, and their contributions to the results of the NZ Banking Group, are not material either individually or in aggregate.

The NZ Banking Group acquired 23% of the shares of Payments NZ Limited on 1 October 2010. Payments NZ Limited owns the governance framework for the New Zealand payments system. The consideration paid for these shares was not material to the NZ Banking Group.

Other transactions with related entities

During the year BT Funds Management (NZ) Limited, amongst other management activities, purchased a bond from a fund that it manages for its book value of $13 million at the date of purchase. This bond is included within other assets.

Note 27 Derivative financial instruments

Derivative contracts include forwards, futures, swaps and options, all of which are bilateral contracts or payment exchange agreements whose values derive from the value of an underlying asset, reference rate or index.

A forward contract obliges one party to buy and the other to sell, a specific underlying product or instrument at a specific price, amount and date in the future. A forward rate agreement is an agreement between two parties establishing a contract interest rate on a notional principal over a specified period commencing at a specific future date.

A futures contract is similar to a forward contract. A futures contract obliges its owner to buy a specific underlying commodity or financial instrument at a specified price on the contract maturity date (or to settle the value for cash). Futures are exchange traded.

A swap transaction obliges the two parties to the contract to exchange a series of cash flows at specified intervals known as payment or settlement dates.

An option contract gives the option holder the right, but not the obligation, to buy or sell a specified amount of a given commodity or financial instrument at a specified price during a certain period or on a specific date. The writer of the option contract is obliged to perform if the holder exercises the right contained therein.

Certain leveraged derivatives include an explicit leverage factor in the payment formula. The leverage factor has the effect of multiplying the notional amount such that the impact of changes in the underlying price or prices may be greater than that indicated by the notional amount alone. The NZ Banking Group has no significant exposure to those types of transactions.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet, but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the NZ Banking Group's exposure to credit or price risks.

The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The notional amount of the derivative financial instruments on hand is the aggregate notional or contractual amounts of instruments that are both favourable or unfavourable.

The NZ Banking Group uses derivatives in two distinct capacities; as a trader and as an end-user as part of its asset and liability management activities.

All derivatives of the NZ Banking Group are held either in the NZ Branch or Westpac New Zealand. Derivatives with related parties are included in due from/due to related entities.

Trading

As a trader, the NZ Branch's primary objective is to derive income from the sale of derivatives to meet the NZ Banking Group's customers' needs. In addition to the sale of derivatives to customers, the NZ Branch also undertakes market making and discretionary trading activities. This process ensures liquidity in the key markets in which the NZ Banking Group operates.

Hedging

The NZ Banking Group enters into derivative transactions that are designated and qualify as either fair value hedges or cash flow hedges for recognised assets and liabilities or forecast transactions. It also enters into derivative transactions that provide economic hedges for risk exposures, but do not meet the requirements for hedge accounting treatment.

Fair value hedges

The NZ Banking Group hedges part of its existing interest rate risk resulting from any potential decrease in the fair value of fixed rate assets denominated in local currency using swaps. The NZ Banking Group also hedges part of its interest rate risk exposure from fixed medium-term debt issuance denominated both in local and foreign currencies through the use of interest rate derivatives.

Cash flow hedges

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

Dual fair value and cash flow hedges

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

Note 27 Derivative financial instruments (continued)

$ millions	NZ Banking Group 2012 Notional	Fair Value Asset	Fair Value (Liability)
Held for trading derivatives			
Interest rate derivatives			
Futures	**5,827**	**-**	**-**
Forwards	**2,354**	**-**	**(11)**
Swaps	**164,156**	**4,118**	**(3,747)**
Options	**1,895**	**33**	**(20)**
Foreign exchange derivatives			
Forwards	**21,232**	**326**	**(459)**
Swaps	**24,922**	**860**	**(672)**
Total held for trading derivatives	**220,386**	**5,337**	**(4,909)**
Fair value hedging derivatives			
Interest rate derivatives			
Swaps	**5,859**	**157**	**(247)**
Foreign exchange derivatives			
Swaps[1]	**4,393**	**-**	**(558)**
Total fair value hedging derivatives	**10,252**	**157**	**(805)**
Cash flow hedging derivatives			
Interest rate derivatives			
Swaps	**4,580**	**12**	**(81)**
Foreign exchange derivatives			
Swaps	**700**	**-**	**(46)**
Total cash flow hedging derivatives	**5,280**	**12**	**(127)**
Total derivatives	**235,918**	**5,506**	**(5,841)**

1 Included with foreign exchange swaps are derivatives designated in both cash flow and fair value hedge relationships under the dual designation strategy.

$ millions	NZ Banking Group 2011 Notional	Fair Value Asset	Fair Value (Liability)
Held for trading derivatives			
Interest rate derivatives			
Futures	12,160	-	-
Forwards	1,333	-	(33)
Swaps	174,854	3,935	(3,569)
Options	4,102	57	(22)
Foreign exchange derivatives			
Forwards	23,846	692	(507)
Swaps	21,516	1,015	(779)
Total held for trading derivatives	237,811	5,699	(4,910)
Fair value hedging derivatives			
Interest rate derivatives			
Swaps	7,052	208	(149)
Foreign exchange derivatives			
Swaps[1]	5,044	122	(218)
Total fair value hedging derivatives	12,096	330	(367)
Cash flow hedging derivatives			
Interest rate derivatives			
Swaps	3,477	11	(164)
Foreign exchange derivatives			
Swaps	319	20	(7)
Total cash flow hedging derivatives	3,796	31	(171)
Total derivatives	253,703	6,060	(5,448)

1 Included with foreign exchange swaps are derivatives designated in both cash flow and fair value hedge relationships under the dual designation strategy.

Note 27 Derivative financial instruments (continued)

$ millions	Notional	Fair Value Asset	Fair Value (Liability)
	NZ Branch 2012		
Held for trading derivatives			
Interest rate derivatives			
Futures	**5,827**	**-**	**-**
Forwards	**2,354**	**-**	**(11)**
Swaps	**171,200**	**4,176**	**(3,841)**
Options	**1,895**	**33**	**(20)**
Foreign exchange derivatives			
Forwards	**21,232**	**326**	**(459)**
Swaps	**27,422**	**860**	**(984)**
Total held for trading derivatives	**229,930**	**5,395**	**(5,315)**
Fair value hedging derivatives			
Interest rate derivatives			
Swaps	**629**	**101**	**-**
Foreign exchange derivatives			
Swaps[1]	**629**	**-**	**(166)**
Total fair value hedging derivatives	**1,258**	**101**	**(166)**
Total derivatives	**231,188**	**5,496**	**(5,481)**

1 Included with foreign exchange swaps are derivatives designated in both cash flow and fair value hedge relationships under the dual designation strategy.

$ millions	Notional	Fair Value Asset	Fair Value (Liability)
	NZ Branch 2011		
Held for trading derivatives			
Interest rate derivatives			
Futures	12,160	-	-
Forwards	1,333	-	(33)
Swaps	182,094	4,042	(3,796)
Options	4,102	57	(22)
Foreign exchange derivatives			
Forwards	23,846	692	(507)
Swaps	24,323	1,085	(901)
Total held for trading derivatives	247,858	5,876	(5,259)
Fair value hedging derivatives			
Interest rate derivatives			
Swaps	685	100	-
Foreign exchange derivatives			
Swaps[1]	790	-	(105)
Total fair value hedging derivatives	1,475	100	(105)
Total derivatives	249,333	5,976	(5,364)

1 Included with foreign exchange swaps are derivatives designated in both cash flow and fair value hedge relationships under the dual designation strategy.

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

%	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 2 Years	2 Years to 3 Years	3 Years to 4 Years	4 Years to 5 Years	Over 5 Years
				NZ Banking Group 2012				
Cash inflows (assets)	**-**	**1**	**69**	**1**	**29**	**-**	**-**	**-**
Cash outflows (liabilities)	**1**	**-**	**63**	**3**	**33**	**-**	**-**	**-**

%	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 2 Years	2 Years to 3 Years	3 Years to 4 Years	4 Years to 5 Years	Over 5 Years
				NZ Banking Group 2011				
Cash inflows (assets)	2	3	11	72	5	2	2	3
Cash outflows (liabilities)	6	4	19	60	5	2	1	3

Note 27 Derivative financial instruments (continued)

For the year ended 30 September 2012 the hedge ineffectiveness recognised in relation to cash flow hedges was nil (30 September 2011: nil) in the NZ Banking Group.

For the NZ Banking Group, the change in the fair value of hedging instruments designated as fair value hedges was a $42 million loss (30 September 2011: $56 million gain) while the change in the fair value of hedged items, attributed to the hedge risk was a $43 million gain (30 September 2011: $53 million loss).

There were no material transactions for which cash flow hedge accounting had to be ceased during the year ended 30 September 2012 as a result of highly probable cash flows no longer being expected to occur.

Note 28 Fair value of financial instruments

Quoted market prices, when available, are used as the measure of fair values. Where quoted market prices do not exist, fair values presented are estimates derived using present values or other market accepted valuation techniques. These techniques involve uncertainties and are affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values.

NZ IFRS 7 requires the disclosure of the fair value of those financial instruments not already carried at fair value in the balance sheet. Fair value for financial instruments has been determined as follows:

Certain short-term financial instruments

For cash and short-term liquid assets, amounts due from other financial institutions with maturities of less than three months, and other types of short-term financial instruments recognised in the balance sheet under 'other assets' and 'other liabilities,' the carrying amount is equivalent to fair value.

Trading securities and available-for-sale securities

For trading securities and available-for-sale securities, the fair values, which are also the carrying amounts, are based on quoted market prices where available. Where a quoted price is not available, the fair value of such instruments is determined by applying a discounted cash flow approach that uses a discount rate which reflects the terms of such instruments and the timing of cash flows.

Floating rate financial instruments

For floating rate financial instruments, including variable rate loans, with no significant change in credit risk, the carrying amount is a reasonable estimate of fair value.

Due from other financial institutions and fixed rate loans

The fair values for amounts due from other financial institutions with maturities of three months or more and fully performing fixed rate loans have been estimated by reference to current rates at which similar advances would be made to financial institutions and other borrowers with a similar credit rating and the same remaining maturities. For amounts due from other financial institutions with maturities of less than three months, the carrying value is a reasonable estimate of fair value.

Due to other financial institutions, deposits and debt issues

The fair value of demand deposits is the amount payable on demand as at balance date. For other liabilities with maturities of less than three months, the carrying amount is a reasonable estimate of fair value.

For liabilities with maturities of three months or longer, fair values have been based on quoted market prices, where such prices exist. Otherwise, fair values have been estimated using the rates currently offered for similar liabilities of similar remaining maturities.

Subordinated debentures

Subordinated debentures are carried at amortised cost. The fair value of subordinated debentures is determined based on quoted market price of Trust Preferred Securities issued by the Overseas Banking Group in the United States of America (refer to Note 24 for further details).

Exchange rate and interest rate contracts

For exchange rate and interest rate contracts, fair values were obtained from quoted market prices, discounted cash flow models or option pricing models as appropriate. The carrying amount and fair value for these contracts are included in derivative financial instruments and amounts due from/to related entities, as applicable.

Other financial assets and liabilities

For all other financial assets and liabilities, the carrying amount approximates fair value. These items are either short-term in nature, reprice frequently or are of a high credit rating.

Interest rates used for determining fair value

The following rates used to discount estimated cash flows, where applicable, are based on the wholesale markets yield curve at the reporting date plus an appropriate constant credit spread:

	NZ Banking Group	
%	**2012**	2011
Loans	**2.63 - 8.20**	2.67 - 7.94
Deposits	**0.10 - 4.99**	0.15 - 7.85
Debt issues	**0.01 - 3.46**	0.01 - 3.91

Note 28 Fair value of financial instruments (continued)

The tables below summarise the categories of financial instruments and the carrying value and fair value of all financial instruments of the NZ Banking Group and the NZ Branch.

	NZ Banking Group 2012							
	Classified at Fair Value through Profit or Loss							
$ millions	Held for Trading	Designated upon Initial Recognition	Hedging	Loans and Receivables	Available-for-sale Financial Assets	Financial Liabilities at Amortised Cost	Total Carrying Amount	Estimated Fair Value
Financial assets								
Cash and balances with central banks	**-**	**-**	**-**	**1,714**	**-**	**-**	**1,714**	**1,714**
Due from other financial institutions	**-**	**-**	**-**	**322**	**-**	**-**	**322**	**322**
Derivative financial instruments	**5,337**	**-**	**169**	**-**	**-**	**-**	**5,506**	**5,506**
Trading securities	**4,028**	**-**	**-**	**-**	**-**	**-**	**4,028**	**4,028**
Available-for-sale securities	**-**	**-**	**-**	**-**	**2,694**	**-**	**2,694**	**2,694**
Loans	**-**	**-**	**-**	**59,892**	**-**	**-**	**59,892**	**60,007**
Life insurance assets	**-**	**237**	**-**	**-**	**-**	**-**	**237**	**237**
Due from related entities	**2,002**	**-**	**-**	**4**	**-**	**-**	**2,006**	**2,006**
Other assets	**-**	**-**	**-**	**384**	**-**	**-**	**384**	**384**
Total financial assets	**11,367**	**237**	**169**	**62,316**	**2,694**	**-**	**76,783**	**76,898**
Financial liabilities								
Due to other financial institutions	**-**	**-**	**-**	**-**	**-**	**214**	**214**	**214**
Deposits	**1,423**	**-**	**-**	**-**	**-**	**41,967**	**43,390**	**43,474**
Derivative financial instruments	**4,909**	**-**	**932**	**-**	**-**	**-**	**5,841**	**5,841**
Trading liabilities	**518**	**-**	**-**	**-**	**-**	**-**	**518**	**518**
Debt issues	**-**	**4,063**	**-**	**-**	**-**	**8,851**	**12,914**	**12,902**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**644**	**644**	**644**
Subordinated debentures	**-**	**-**	**-**	**-**	**-**	**712**	**712**	**707**
Due to related entities	**1,605**	**-**	**-**	**-**	**-**	**6,279**	**7,884**	**7,856**
Total financial liabilities	**8,455**	**4,063**	**932**	**-**	**-**	**58,667**	**72,117**	**72,156**

	NZ Banking Group 2011							
	Classified at Fair Value through Profit or Loss							
$ millions	Held for Trading	Designated upon Initial Recognition	Hedging	Loans and Receivables	Available-for-sale Financial Assets	Financial Liabilities at Amortised Cost	Total Carrying Amount	Estimated Fair Value
Financial assets								
Cash and balances with central banks	-	-	-	1,871	-	-	1,871	1,871
Due from other financial institutions	-	-	-	699	-	-	699	699
Derivative financial instruments	5,699	-	361	-	-	-	6,060	6,060
Trading securities	6,065	-	-	-	-	-	6,065	6,065
Available-for-sale securities	-	-	-	-	1,518	-	1,518	1,518
Loans	-	-	-	58,114	-	-	58,114	58,284
Life insurance assets	-	186	-	-	-	-	186	186
Due from related entities	2,264	-	-	8	-	-	2,272	2,272
Other assets	-	-	-	458	-	-	458	458
Total financial assets	14,028	186	361	61,150	1,518	-	77,243	77,413
Financial liabilities								
Due to other financial institutions	-	-	-	-	-	778	778	778
Deposits	1,556	-	-	-	-	38,019	39,575	39,653
Derivative financial instruments	4,910	-	538	-	-	-	5,448	5,448
Trading liabilities	1,286	-	-	-	-	-	1,286	1,286
Debt issues	-	7,727	-	-	-	9,903	17,630	17,259
Other liabilities	-	-	-	-	-	1,166	1,166	1,166
Subordinated debentures	-	-	-	-	-	785	785	712
Due to related entities	1,063	-	-	-	-	5,629	6,692	6,692
Total financial liabilities	8,815	7,727	538	-	-	56,280	73,360	72,994

Note 28 Fair value of financial instruments (continued)

$ millions	Classified at Fair Value through Profit or Loss Held for Trading	Hedging	Loans and Receivables	Financial Liabilities at Amortised Cost	Total Carrying Amount	Estimated Fair Value
	NZ Branch 2012					
Financial assets						
Cash and balances with central banks	**-**	**-**	**119**	**-**	**119**	**119**
Derivative financial instruments	**5,395**	**101**	**-**	**-**	**5,496**	**5,496**
Trading securities	**1,988**	**-**	**-**	**-**	**1,988**	**1,988**
Loans	**-**	**-**	**385**	**-**	**385**	**387**
Due from related entities	**2,958**	**-**	**6,727**	**-**	**9,685**	**9,685**
Other assets	**-**	**-**	**162**	**-**	**162**	**162**
Total financial assets	**10,341**	**101**	**7,393**	**-**	**17,835**	**17,837**
Financial liabilities						
Due to other financial institutions	**-**	**-**	**-**	**211**	**211**	**211**
Derivative financial instruments	**5,315**	**166**	**-**	**-**	**5,481**	**5,481**
Trading liabilities	**518**	**-**	**-**	**-**	**518**	**518**
Other liabilities	**-**	**-**	**-**	**122**	**122**	**122**
Subordinated debentures	**-**	**-**	**-**	**712**	**712**	**707**
Due to related entities	**1,605**	**-**	**-**	**6,365**	**7,970**	**7,970**
Total financial liabilities	**7,438**	**166**	**-**	**7,410**	**15,014**	**15,009**

$ millions	Classified at Fair Value through Profit or Loss Held for Trading	Hedging	Loans and Receivables	Financial Liabilities at Amortised Cost	Total Carrying Amount	Estimated Fair Value
	NZ Branch 2011					
Financial assets						
Cash and balances with central banks	-	-	656	-	656	656
Derivative financial instruments	5,876	100	-	-	5,976	5,976
Trading securities	2,803	-	-	-	2,803	2,803
Loans	-	-	6,787	-	6,787	6,791
Due from related entities	2,877	-	3,552	-	6,429	6,429
Other assets	-	-	308	-	308	308
Total financial assets	11,556	100	11,303	-	22,959	22,963
Financial liabilities						
Due to other financial institutions	-	-	-	678	678	678
Deposits	-	-	-	4,689	4,689	4,688
Derivative financial instruments	5,259	105	-	-	5,364	5,364
Trading liabilities	1,286	-	-	-	1,286	1,286
Other liabilities	-	-	-	640	640	640
Subordinated debentures	-	-	-	785	785	712
Due to related entities	1,064	-	-	5,789	6,853	6,853
Total financial liabilities	7,609	105	-	12,581	20,295	20,221

Note 28 Fair value of financial instruments (continued)

Fair valuation control framework

The NZ Banking Group uses a well established Fair Valuation Control Framework to determine the fair value of financial assets and financial liabilities. The framework consists of policies and procedures that ensure the NZ Banking Group is in compliance with relevant accounting, industry and regulatory standards. This framework includes details on the approach taken with respect to the revaluation of financial instruments, independent price verification, fair value adjustments and financial reporting.

The method of determining a fair value according to the Fair Valuation Control Framework falls into one of two main approaches:

- Mark-to-market: where the valuation uses independent unadjusted quoted market prices.
- Mark-to-model: where valuation techniques are used to determine the valuation.

Valuation techniques often require adjustments to ensure correct fair value representation. The NZ Banking Group's valuation adjustments include:

- Credit valuation adjustment ('**CVA**'): Some market and model derived valuations assume similar credit quality for all counterparties. To correct for this assumption, a CVA is employed on the majority of derivative positions which reflects the market view of the counterparty credit risk. A derivative valuation adjustment ('**DVA**') is employed to adjust for the NZ Banking Group's own credit risk. The NZ Banking Group uses a Monte Carlo simulation methodology to calculate the expected future credit exposure for all derivative exposures, including inputs regarding probabilities of default ('**PDs**') and loss given default ('**LGD**'). PDs are derived from market observed credit spreads by reference to credit default swap ('**CDS**') sector curves for the relevant tenors to calculate CVA, and the Overseas Bank's CDS curve for the relevant tenors to calculate DVA. PDs are then applied to the horizon of potential exposures to derive both the CVA and DVA.
- Bid-offer spreads adjustment: The fair value of financial assets and financial liabilities should reflect bid prices for assets and offer prices for liabilities. Prices are adjusted to reflect current bid-offer spreads.

The fair values of large holdings of financial instruments are based on a multiple of the estimated value of a single instrument and do not include block adjustments for the size of the holding.

Fair value hierarchy

The NZ Banking Group categorises all fair value measurements according to the following fair value hierarchy:

- Quoted market price (Level 1)

  This valuation technique uses recent unadjusted quoted prices for identical assets or liabilities in active markets where the price represents actual and regularly occurring market transactions on an arm's length basis. Financial instruments included in this category are spot and exchange traded derivatives for commodities, foreign exchange and interest rate products.
- Valuation technique using observable inputs (Level 2)

  This valuation technique is used for financial instruments where quoted market prices are not available so prices are derived from standard valuation models, and inputs to these models are directly observable. The valuation techniques include the use of discounted cash flow analysis, option pricing models and other valuation techniques widely used and accepted by market participants. The financial instruments included in this category are mainly over the counter derivatives with observable market inputs and financial instruments with fair value derived from consensus pricing with sufficient contributors, including interest rate swaps, foreign exchange swaps, interest rate forwards, foreign exchange forwards, interest rate futures, and interest rate options, and trading securities including government bonds, semi-government bonds, corporate fixed rate bonds and floating rate notes ('**FRN**').
- Valuation technique with significant non-observable inputs (Level 3)

  This valuation technique is used where at least one significant input is not observable and reliance is placed on reasonable assumptions based on market conditions. These estimates are calibrated against industry standards, economic models and observable transaction prices where possible. Financial instruments included in this category show illiquidity in the market. Some valuations rely on estimation from related markets or proxies. Financial instruments included in this category are long-dated NZD caps and inflation-indexed derivative instruments.

Valuation techniques, valuation inputs and asset classification

A variety of valuation techniques are used to derive the fair value of each instrument. Mark-to-market is the preferred valuation technique for all products. However, modelling techniques are used to derive fair value when markets are illiquid and prices not quoted. The specific valuation techniques, the observability of the inputs used in valuation models and the subsequent classification for each significant product category are outlined below:

*Interest rate ('**IR**') derivatives*

- Exchange traded IR options and futures are liquid and their prices are observable. No modelling or assumptions are used in their valuation and therefore IR options and futures are categorised as Level 1 instruments.
- Other interest rate derivatives are products with a pay-off linked to interest rates i.e. New Zealand Bank Bill Reference Rate ('**BKBM**') or LIBOR or inflation rates. These products include interest rate and inflation swaps, swaptions, caps, floors, collars and other complex interest rate derivatives. For these instruments, as market prices are unavailable, the NZ Banking Group uses valuation models to derive fair value. The models are industry standard and mostly employ a Black-Scholes framework to calculate the expected future value of payments by product, which is discounted back to a present value. The model's interest rate inputs are benchmark interest rates such as BKBM and active broker quoted interest rates in the swap, bond and futures markets. Interest rate volatilities are sourced through a consensus data provider. As such the input parameters into the models are deemed market observable and therefore other interest rate derivatives are categorised as Level 2 instruments.

Note 28 Fair value of financial instruments (continued)

*Foreign exchange ('**FX**') products*

- There are observable markets for FX spot contracts in major global currencies. No modelling or assumptions are used in the valuation of these instruments. These assets are therefore categorised as Level 1 instruments.
- FX swaps and forwards are not traded on exchanges. FX swap and forward valuations are derived from consensus data providers. Both simple and complex derivatives are valued using industry standard models which revolve around a Black-Scholes framework. The inputs to the calculation include FX spot rates, interest rates and FX volatilities. In general, these inputs are market observable or provided by consensus data providers. Therefore, FX swaps and forwards are categorised as Level 2 instruments.

Debt market products

Government bonds, corporate bonds, commercial paper and notes generally do not have quoted market prices. The NZ Banking Group uses valuation models to derive the fair value of these instruments. The valuation techniques are standard and mainly use a discounted cash flow approach. The main model inputs are observed instrument data used to derive the discount curves, and therefore, debt market products are classified as Level 2 instruments.

Certificates of deposit

The fair value of certificates of deposit uses a discounted cash flow analysis using market rates offered for deposits of similar remaining maturities and are therefore classified as Level 2 instruments.

Debt issues at fair value

Where a quoted price is not available, the fair value of debt issues uses a discounted cash flow approach, using a discount rate which reflects the terms of the instrument and the timing of cash flows adjusted for market observable changes in the applicable credit rating of the NZ Banking Group. These instruments are therefore classified as Level 2 instruments.

Disclosure of fair value

Due to the number of different valuation models used and the underlying assumptions made regarding inputs selected, such as timing and amounts of future cash flows, discount rates, credit risk and volatility, it is often difficult to compare the fair value information disclosed here against fair value information disclosed by other financial institutions.

The fair values disclosed in this note represent estimates at which the instruments could be exchanged. However, the intention is to hold many of these instruments to maturity and thus it is possible that the realised amount may differ to the amounts disclosed in the tables below.

There were no material amounts of changes in fair value estimated using a valuation technique but incorporating significant non-observable inputs, that were recognised in the income statements of the NZ Banking Group and the NZ Branch during the year ended 30 September 2012 (30 September 2011: no material changes in fair value).

There have been no significant transfers between Levels 1 and 2 during the year ended 30 September 2012 (30 September 2011: nil). There have also been no significant transfers into/out of Level 3 during the year ended 30 September 2012 (30 September 2011: nil).

The following table summarises the basis for the determination of the fair values of financial instruments that are measured at fair value after initial recognition:

	NZ Banking Group 2012				NZ Branch 2012			
$ millions	Quoted Market Prices (Level 1)	Valuation Techniques (Market Observable Inputs) (Level 2)	Valuation Techniques (Non-market Observable Inputs)[1] (Level 3)	Total	Quoted Market Prices (Level 1)	Valuation Techniques (Market Observable Inputs) (Level 2)	Valuation Techniques (Non-market Observable Inputs)[1] (Level 3)	Total
Financial assets								
Derivative financial instruments	3	5,500	3	5,506	3	5,490	3	5,496
Trading securities	-	4,028	-	4,028	-	1,988	-	1,988
Available-for-sale securities	70	2,624	-	2,694	-	-	-	-
Life insurance assets	-	237	-	237	-	-	-	-
Due from related entities	-	2,002	-	2,002	-	2,958	-	2,958
Total financial assets carried at fair value	73	14,391	3	14,467	3	10,436	3	10,442
Financial liabilities								
Deposits	-	1,423	-	1,423	-	-	-	-
Derivative financial instruments	7	5,818	16	5,841	7	5,458	16	5,481
Trading liabilities	-	518	-	518	-	518	-	518
Debt issues at fair value	-	4,063	-	4,063	-	-	-	-
Due to related entities	-	1,605	-	1,605	-	1,605	-	1,605
Total financial liabilities carried at fair value	7	13,427	16	13,450	7	7,581	16	7,604

1 Derivative balances within this category of the fair value hierarchy are not material to the total derivative balance.

Note 28 Fair value of financial instruments (continued)

$ millions	NZ Banking Group 2011 Quoted Market Prices (Level 1)	NZ Banking Group 2011 Valuation Techniques (Market Observable Inputs) (Level 2)	NZ Banking Group 2011 Valuation Techniques (Non-market Observable Inputs)[1] (Level 3)	NZ Banking Group 2011 Total	NZ Branch 2011 Quoted Market Prices (Level 1)	NZ Branch 2011 Valuation Techniques (Market Observable Inputs) (Level 2)	NZ Branch 2011 Valuation Techniques (Non-market Observable Inputs)[1] (Level 3)	NZ Branch 2011 Total
Financial assets								
Derivative financial instruments	10	6,048	2	6,060	10	5,964	2	5,976
Trading securities	-	6,065	-	6,065	-	2,803	-	2,803
Available-for-sale securities	50	1,468	-	1,518	-	-	-	-
Life insurance assets	-	186	-	186	-	-	-	-
Due from related entities	49	2,215	-	2,264	49	2,828	-	2,877
Total financial assets carried at fair value	109	15,982	2	16,093	59	11,595	2	11,656
Financial liabilities								
Deposits	-	1,556	-	1,556	-	-	-	-
Derivative financial instruments	22	5,408	18	5,448	22	5,324	18	5,364
Trading liabilities	-	1,286	-	1,286	-	1,286	-	1,286
Debt issues at fair value	-	7,727	-	7,727	-	-	-	-
Due to related entities	70	993	-	1,063	70	994	-	1,064
Total financial liabilities carried at fair value	92	16,970	18	17,080	92	7,604	18	7,714

1 Derivative balances within this category of the fair value hierarchy are not material to the total derivative balance.

Note 29 Commitments and contingent liabilities

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Commitments for capital expenditure				
Due within one year	**4**	2	**-**	-
Other expenditure commitments:				
One year or less	**95**	89	**-**	-
Between one and five years	**293**	306	**-**	-
Over five years	**-**	34	**-**	-
Total other expenditure commitments	**388**	429	**-**	-
Lease commitments (all leases are classified as operating leases)				
Premises and sites	**219**	230	**-**	-
Motor vehicles	**8**	8	**-**	-
Total lease commitments	**227**	238	**-**	-
Lease commitments are due as follows:				
One year or less	**44**	44	**-**	-
Between one and five years	**117**	104	**-**	-
Over five years	**66**	90	**-**	-
Total lease commitments	**227**	238	**-**	-
Contingent liabilities and commitments				
Direct credit substitutes	**335**	333	**255**	255
Loan commitments with certain drawdown	**177**	164	**-**	-
Transaction-related contingent items	**796**	700	**-**	443
Underwriting and sub-underwriting facilities	**-**	300	**-**	300
Short-term, self-liquidating trade-related contingent liabilities	**397**	443	**-**	104
Other commitments to provide financial services	**19,118**	17,336	**88**	5,933
Total contingent liabilities and commitments	**20,823**	19,276	**343**	7,035

The NZ Banking Group is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers and in managing its own risk profile. These financial instruments include commitments to extend credit, financial guarantees, standby letters of credit and underwriting facilities.

The NZ Banking Group's exposure to credit loss in the event of non-performance by the other party to such financial instruments is represented by the contract or notional amount of those instruments. However, some commitments to extend credit and provide underwriting facilities can be cancelled or revoked at any time at the NZ Banking Group's option.

The NZ Banking Group uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet financial instruments.

Note 29 Commitments and contingent liabilities (continued)

The NZ Banking Group takes collateral where it is considered necessary to support both on and off-balance sheet financial instruments with credit risk. The NZ Banking Group evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral taken, if deemed necessary, on the provision of a financial facility is based on management's credit evaluation of the counterparty. The collateral taken varies, but may include cash deposits, receivables, inventory, plant and equipment, real estate and investments.

The NZ Banking Group is obliged to repurchase any loans sold to and:

(a) held by the Westpac Home Loan Trust ('**HLT**') where it is discovered within 120 days of sale that those loans were not eligible for sale when sold;

(b) held by WNZSL securitisation programme where the loan ceases to conform to certain terms and conditions of the WNZSL securitisation programme;

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

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

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

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

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

Westpac New Zealand guarantees the due and punctual payment of all sums payable to the holders of the debt securities issued by its indirect wholly-owned subsidiary, WSNZL, the proceeds of which are immediately on-lent to Westpac New Zealand. The aggregate amount of outstanding principal and interest as at 30 September 2012 was $10,041 million (30 September 2011: $15,945 million).

In addition, the NZ Banking Group (through WNZCBL) guarantees covered bonds issued by WSNZL (refer to Note 13 for further details).

Other contingent liabilities

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

Westpac (NZ) Investments Limited ('**WNZIL**'), a subsidiary of Westpac New Zealand, leases the majority of the properties occupied by the NZ Banking Group. As is normal practice, the lease agreements contain 'make good' provisions, which require WNZIL, upon termination of a lease, to return the premises to the lessor in the original condition. The maximum amount payable by WNZIL upon vacation of all leased premises subject to these provisions as at 30 September 2012 was estimated to be $22 million (30 September 2011: $22 million). No amount has been recognised for the $22 million in estimated maximum vacation payments as the NZ Banking Group believes it is highly unlikely that WNZIL would incur a material operating loss as a result of such 'make good' provisions in the normal course of its business operations.

Other commitments

As at 30 September 2012, the NZ Banking Group had commitments in respect of forward purchases and sales of foreign currencies, interest rate and currency swap transactions, futures and options contracts, provision of credit, underwriting facilities and other arrangements entered into in the normal course of business. The NZ Banking Group has management systems and operational controls in place to manage interest rate, currency and credit risk (refer to Note 36). Accordingly, it is not envisaged that any liability resulting in material loss to the NZ Banking Group will arise from these transactions to the extent that a provision has not been provided for under the NZ Banking Group's usual practices.

Note 30 Segment information

The NZ Banking Group operates predominantly in the consumer, business and institutional banking sectors within New Zealand. On this basis no geographical segment information is provided.

The basis of segment reporting reflects the management of the business, rather than the legal structure of the NZ Banking Group. There is no difference in accounting measurement between the management and legal structures. The operating segment results have been presented on a management reporting basis and consequently internal charges and transfer pricing adjustments have been reflected in the performance of each operating segment. Intersegment pricing is determined on a cost recovery basis.

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

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

- Retail Banking provides financial services for private individuals;
- Wealth provides financial services for high net worth individuals, funds management and insurance distribution;
- Business Banking provides financial services for small to medium size enterprise customers, corporates and agricultural businesses. Business Banking also provides domestic transactional banking to the New Zealand Government; and
- Institutional Banking provides a broad range of financial services to large corporate, institutional and government customers and the supply of derivatives and risk management products to the entire Westpac customer base in New Zealand.

Retail Banking and Wealth have been aggregated and disclosed as the Consumer Banking reportable segment. Business Banking and Institutional Banking are separately reportable segments.

Note 30 Segment information (continued)

Reconciling items primarily represent:

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

Comparative information for net operating income from external customers and net internal operating income has been changed to ensure consistent presentation with the current reporting period.

	NZ Banking Group				
$ millions	Consumer Banking	Business Banking	Institutional Banking	Reconciling Items[1]	Total
Year ended 30 September 2012					
Net interest income	**810**	**495**	**163**	**57**	**1,525**
Non-interest income	**304**	**88**	**175**	**15**	**582**
Net operating income	**1,114**	**583**	**338**	**72**	**2,107**
Net operating income from external customers	**1,485**	**1,037**	**395**	**(810)**	**2,107**
Net internal operating income	**(371)**	**(454)**	**(57)**	**882**	**-**
Net operating income	**1,114**	**583**	**338**	**72**	**2,107**
Depreciation	**(2)**	**-**	**-**	**(26)**	**(28)**
Software amortisation costs	**-**	**-**	**-**	**(38)**	**(38)**
Other operating expenses	**(196)**	**(74)**	**(55)**	**(481)**	**(806)**
Total operating expenses	**(198)**	**(74)**	**(55)**	**(545)**	**(872)**
Impairment charges on loans	**(38)**	**(144)**	**(6)**	**4**	**(184)**
Share of profit of associate accounted for using equity method	**-**	**-**	**-**	**1**	**1**
Profit before income tax expense	**878**	**365**	**277**	**(468)**	**1,052**
Total gross loans	**31,383**	**22,129**	**7,209**	**(222)**	**60,499**
Total deposits	**24,744**	**11,371**	**5,852**	**1,423**	**43,390**
Year ended 30 September 2011					
Net interest income	755	472	164	143	1,534
Non-interest income	283	81	149	(4)	509
Net operating income	1,038	553	313	139	2,043
Net operating income from external customers	1,548	1,079	457	(1,041)	2,043
Net internal operating income	(510)	(526)	(144)	1,180	-
Net operating income	1,038	553	313	139	2,043
Depreciation	(2)	-	-	(20)	(22)
Software amortisation costs	-	-	-	(42)	(42)
Other operating expenses	(206)	(76)	(57)	(442)	(781)
Total operating expenses	(208)	(76)	(57)	(504)	(845)
Impairment charges on loans	(64)	(167)	(5)	10	(226)
Share of profit of associate accounted for using equity method	-	-	-	1	1
Profit before income tax expense	766	310	251	(354)	973
Total gross loans	30,625	21,421	6,998	(265)	58,779
Total deposits	22,908	10,387	4,689	1,591	39,575

1 Included in the reconciling items for total operating expenses is $548 million (30 September 2011: $500 million) of head office operating expenses, which are not allocated to a business unit that meets the definition of an operating segment.

Note 31 Superannuation commitments

The NZ Banking Group has a hybrid (defined contribution and defined benefit) superannuation scheme for staff in New Zealand. Contributions, as specified in the rules of the scheme, are made by the NZ Banking Group as required. The defined benefit scheme has been closed to new members since 1 April 1990. An actuarial valuation of the scheme is undertaken periodically, with the last actuarial assessment of the funding status undertaken as at 30 June 2011. Contributions to the defined benefit scheme are at a rate sufficient to keep the scheme solvent, and contributions are currently being made to the defined benefit scheme at the rate of 12% (before employer's superannuation contribution tax) of members' salaries.

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

The below table details the primary actuarial assumptions used in the calculations of the defined benefit scheme liability:

	NZ Banking Group	
%	**2012**	2011
Primary actuarial assumptions used in the above calculations:		
Discount rate	**2.5**	3.2
Expected return on scheme assets – active members (end of year)	**6.0**	6.0
Expected return on scheme assets – pensioners	**6.0**	6.0
Rate of increase in salaries	**3.5**	3.5
Rate of increase for pensions	**2.5**	2.5
Asset allocation		
Cash	**0.9**	0.6
Equity instruments	**57.1**	55.0
Debt instruments	**42.0**	44.4
Total asset allocation	**100.0**	100.0

The carrying value of the retirement benefit deficit is disclosed as part of Note 23.

Note 32 Key management personnel

Key management personnel compensation

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

	NZ Banking Group	
$'000s	**Year Ended 30-Sep-12**	Year Ended 30-Sep-11
Salaries and other short-term benefits	**11,895**	11,712
Post-employment benefits	**712**	965
Other termination benefits	**210**	763
Share-based payments	**3,393**	3,480
Total key management compensation	**16,210**	16,920

Where the Directors of the Overseas Bank have received remuneration from the NZ Banking Group, the amounts are included above. Details of Directors' remuneration are disclosed in the Overseas Banking Group's 30 September 2012 Annual Financial Report.

Loans and deposits with key management personnel

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

As at 30 September 2012 no provisions have been recognised in respect of loans given to key management personnel and their related parties (30 September 2011: nil).

Other key management personnel transactions

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

Note 33 Securitisation, funds management, other fiduciary activities and the marketing and distribution of insurance products

Securitisation

As at 30 September 2012 the NZ Banking Group had securitised assets amounting to $215 million (30 September 2011: $305 million) which had been sold by the NZ Banking Group to external parties being HLT and the Westpac Mortgage Investment Fund ('**MIF**') via the HLT. HLT and MIF were established, pursuant to trust deeds between BT Funds Management (NZ) Limited and The New Zealand Guardian Trust Company Limited, with the principal purpose of investing in housing loans originated by the NZ Banking Group. The purchase of these housing loans has been funded with the proceeds of units subscribed for, and issued to, retail investors in New Zealand. The NZ Banking Group receives fees for various services provided to HLT and MIF on an arm's length basis, including servicing fees. These fees are recognised over the financial periods in which the costs are borne. The securitised assets have been derecognised from the financial statements of the NZ Banking Group as the risks and rewards of the assets have been substantially transferred to external parties.

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

The NZ Banking Group has a $5.0 billion (30 September 2011: $5.0 billion) internal mortgage-backed securitisation programme. WNZSL issued residential mortgage backed securities to fund the purchase of housing loans from Westpac New Zealand. Those securities are currently held by Westpac New Zealand. The most senior rated securities (30 September 2012: $4.75 billion, 30 September 2011: $4.75 billion) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Holding a portion of mortgages in securitised format enables the NZ Banking Group to maintain a readily available source of cash should market conditions become difficult. It takes advantage of the Reserve Bank's guidelines for its overnight reverse repo facility and open market operations, which allows banks in New Zealand to offer residential mortgage backed securities (secured by residential mortgage assets from their own balance sheets) as collateral for the Reserve Bank's repurchase agreements.

In addition to its own scheme, the NZ Banking Group provides financial services, on an arm's length basis, to customers' securitisation schemes.

Funds management and other fiduciary activities

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

Term PIE is managed by a member of the NZ Banking Group (refer to Note 26 for further details) and invests in deposits with Westpac New Zealand. Westpac New Zealand is considered to control Term PIE, and as such Term PIE is consolidated within the financial statements of the NZ Banking Group.

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

$ millions	2012	2011
Private and priority	**449**	764
Retirement plans	**1,819**	1,301
Retail unit trusts	**1,589**	1,259
Wholesale unit trusts	**305**	257
Term PIE	**720**	496
Total funds under management	**4,882**	4,077

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

Marketing and distribution of insurance products

The NZ Banking Group markets both life insurance and general insurance products. The insurance products are distributed through the NZ Banking Group's distribution channels. The life insurance products are underwritten by Westpac Life and by external third party insurance companies. The general insurance products are fully underwritten by external third party insurance companies. Disclosure statements are made in all marketing material that the products are underwritten by those companies and that the Overseas Banking Group does not guarantee the obligations of, or any products issued by, those companies.

Risk management

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

Note 34 Insurance business

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

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

$ millions	2012	2011
Total assets	**194**	161
As a percentage of total assets of the NZ Banking Group	**0.25%**	0.21%

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

Note 35 Capital adequacy

%	30-Sep-12 Unaudited	30-Sep-11 Unaudited
Overseas Banking Group[1]		
Tier One Capital ratio	**10.3**	9.7
Total Capital ratio	**11.7**	11.0
Overseas Bank (Extended Licensed Entity)[1]		
Tier One Capital ratio	**10.1**	9.6
Total Capital ratio	**11.8**	11.4

1 The capital ratios represent information mandated by APRA.

Basel II came into effect on 1 January 2008. The Overseas Banking Group is accredited by APRA to use the Advanced Internal Ratings Based ('**Advanced IRB**') approach for credit risk, the Advanced Measurement Approach ('**AMA**') for operational risk and the internal model approach for Interest Rate Risk in the Banking Book ('**IRRBB**') for calculating regulatory capital (known as 'Advanced Accreditation') and is required by APRA to hold minimum capital at least equal to that specified under the Advanced IRB and AMA methodologies. Under New Zealand regulations this methodology is referred to as Basel II (internal models based) approach. With this accreditation the Overseas Banking Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly and a semi-annual basis. This information is made available to users via the Overseas Banking Group website (www.westpac.com.au). The aim is to allow the market to better assess the Overseas Banking Group's risk and reward assessment process and hence increase the scrutiny of these processes.

The Overseas Banking Group, and the Overseas Bank (Extended Licensed Entity) as defined by APRA, exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2012. APRA specifies a minimum prudential capital ratio for the Overseas Banking Group, which is not made publicly available.

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

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

- consideration of both economic (calibrated to the Overseas Banking Group's AA debt rating) and regulatory capital driven requirements;
- a process which challenges the capital measures, coverage and requirements which incorporates a comparison of economic and regulatory requirements and the use of the Quantitative Scenario Analysis (stress testing) framework that considers amongst others, the impact of adverse economic scenarios that threaten the achievement of planned outcomes;
- consideration of the perspectives of external stakeholders such as regulators, rating agencies and equity investors; and
- the development of a capital management strategy including target capital ratios, capital buffers and contingency plans which guide the development of specific capital plans.

Current market conditions and the uncertainty around responses to the global financial crisis require the Overseas Banking Group to maintain conservative levels of capital.

Since 2012 the Overseas Banking Group's capital ratios have been measured using the new Basel 2.5 standards, which became effective from 1 January 2012. These standards principally involved changes in risk-weighted assets applied to market risk and to securitisation.

Note 36 Risk management

General

The NZ Banking Group regards the management of risk to be a fundamental management activity performed at all levels. Supporting this approach is a framework of core risk principles, policies and processes for measuring and monitoring risk ('**Risk Governance Framework**').

Westpac New Zealand, a member of the NZ Banking Group, is a locally incorporated registered bank. Westpac New Zealand's risk governance framework is closely aligned with that of the Overseas Banking Group, however, the Board of Westpac New Zealand is responsible for the risk management of that bank and its subsidiaries. For further information on the risk management policies applying to Westpac New Zealand, refer to Westpac New Zealand's most recently published Disclosure Statement.

Risk governance framework

The Risk Governance Framework is approved by the Board Risk Management Committee ('**Group BRMC**') and implemented through the Chief Executive for Westpac New Zealand ('**NZ CE**') and the executive management team.

The Overseas Bank has a Board Audit Committee ('**Group BAC**') and Group BRMC. The Group BAC and Group BRMC are Board committees that are responsible for setting the Overseas Banking Group's risk appetite and overseeing the Overseas Banking Group's risk profile.

The Group BAC comprises four non-executive and independent Directors of the Overseas Bank. The Group BAC assists the Board in fulfilling its responsibilities in relation to the external reporting of financial information, internal control of operational risk and the efficiency and effectiveness of audit and compliance with laws and regulations.

The Group BRMC monitors the alignment of the Overseas Banking Group's risk profile with its risk appetite, which is defined by the Board Risk Appetite Statement, and with its current and future capital requirements. The Group BRMC receives regular reports from executive management on the effectiveness of their management of the Overseas Banking Group's material business risks.

The NZ CE and executive management team are responsible for implementing the Board-approved Risk Management Framework and developing policies, controls, processes and procedures for identifying and managing risk arising from the NZ Banking Group's activities.

Note 36 Risk management (continued)

Core risk principles

The NZ Banking Group's core risk principles are the key guidelines for all risk management within the NZ Banking Group. These principles reflect the standards and ideals expressed in the NZ Banking Group's vision, values and code of conduct and are embedded in all levels of risk management policy including rules, procedures and training.

The principles for managing risk are:

- aligning the NZ Banking Group's actions with its values, strategies and objectives;
- following ethical selling practices and delivering products and services that meet the needs of customers;
- accepting that with responsibility comes accountability;
- establishing clear decision-making criteria;
- ensuring that increased risk is rewarded with increased return; and
- identifying and managing risk in all areas of responsibility.

Types of risk

The key risks that the NZ Banking Group is subject to are specific banking risks and risks arising from the general business environment. The Risk Management Framework identifies five broad main types of risk:

- Credit risk: the risk of financial loss where a customer or counterparty fails to meet their financial obligations;
- Liquidity risk: the risk that the NZ Banking Group will not be able to fund its assets and meet obligations as they come due, without incurring unacceptable losses;
- Market risk: the risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices. This includes interest rate risk in the banking book – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities;
- Operational risk: the risk of loss resulting from inadequate or failed internal processes, human error or misconduct, or from external events. It includes, among other things, technology risk, model risk and outsourcing risk; and
- Compliance risk: the risk of legal or regulatory sanction, and financial or reputational loss arising from the NZ Banking Group's failure to abide by the compliance obligations required of the NZ Banking Group.

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

Other risks include:

- Business risk: the risk associated with the vulnerability of a line of business to changes in the business environment;
- Environmental, Social and Governance risk: The risk that the NZ Banking Group damages its reputation or financial performance due to failure to recognise or address material existing or emerging sustainability related environmental, social and governance issues;
- Reputation risk: the risk to earnings or capital arising from negative public opinion, resulting from the loss of reputation or public trust and standing; and
- Subsidiary (contagion) risk: the risk that problems arising in other members of the NZ Banking Group may compromise the financial position of the NZ Branch.

Group Assurance

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

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

Reviews in respect of risk management systems

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

Group Assurance's Credit Risk Assurance and Model Risk Review functions have a rolling programme of credit and model risk reviews throughout the financial year. New Zealand Assurance, with support from the Overseas Bank's Group Assurance unit, also periodically reviews the NZ Banking Group's Operational, Market, Funding and Liquidity Risk Frameworks. These reviews are not conducted by a party which is external to the NZ Banking Group or the Overseas Bank, though they are independent and have no direct authority over the activities of management. With a view to continuously improving its risk management, Westpac New Zealand commissioned an external review of its risk management framework during the year ended 30 September 2012.

Note 36 Risk management (continued)
36.1 Compliance and operational risk

Westpac New Zealand's Executive Risk and Audit Committee ('**ERAC**') is responsible for overseeing the effectiveness and implementation of the Operational Risk and Compliance Frameworks. ERAC meets quarterly and is required to escalate material matters to Westpac New Zealand's Board Risk Management Committee ('**BRMC**') and/or the relevant Overseas Bank's Group Operational Risk Committee.

Compliance risk

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

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

Operational risk

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

The NZ Banking Group has adopted the Overseas Bank's Operational Risk Framework. This Framework outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, operational risk in change, reporting and monitoring, and operational risk capital allocation.

All business and support areas are responsible for the ongoing identification, measurement, monitoring and mitigation of operational risk. On a quarterly basis, as part of the operational risk and compliance governance process, each of the business and support areas formally report on the effectiveness of their management of operational risk. This process is supported by active input from Operational Risk, Compliance and New Zealand Assurance. The results of this process are reported quarterly to the Overseas Bank's Group Operational Risk and Compliance Committee as well as to the ERAC, chaired by the Westpac New Zealand Chief Risk Officer.

36.2 Funding and liquidity risk

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

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

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

Liquidity risk management framework

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

- roles and responsibilities;
- contingency planning;
- principal framework components, policies and reports along with the frequency of review and authority for approval;
- measurement and modelling approaches;
- scenarios covered;
- liquidity risk limits;
- reporting and escalation processes; and
- minimum holdings of liquidity assets.

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

Daily liquidity modelling and reporting

The NZ Banking Group's liquidity position is modelled and reported on a daily basis covering:

- the level of liquid assets held;
- a going concern scenario; and
- a crisis funding scenario.

Note 36 Risk management (continued)

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

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

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

Annual funding plan

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

- trends in global debt markets;
- funding alternatives;
- peer analysis;
- estimation of wholesale funding task;
- estimated market capacity;
- funding risk analysis; and
- allocation of funding costs.

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

Contingency planning

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

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

Sources of liquidity

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

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

Liquid assets

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

	NZ Banking Group	
$ millions	**2012**	2011
Cash	**1,600**	1,630
Due from other financial institutions	**-**	575
Supranational securities	**414**	166
NZ Government securities	**2,575**	2,937
NZ public securities	**206**	26
NZ corporate securities	**2,483**	2,318
Residential mortgage-backed securities	**3,992**	3,992
Total liquid assets	**11,270**	11,644

Note 36 Risk management (continued)

Liquidity analysis

The following liquidity analysis for financial assets and financial liabilities presents contractual undiscounted cash flows receivable and payable, and is based on the remaining period as at the reporting date to the contractual maturity. The balances in the tables below may not agree to the balance sheet totals as the tables incorporate all cash flows on an undiscounted basis, which include both principal and associated future interest income/expense accruals.

	NZ Banking Group						
	2012						
$ millions	On Demand	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Total
Financial assets							
Cash and balances with central banks	1,714	-	-	-	-	-	1,714
Due from other financial institutions	-	322	-	-	-	-	322
Derivative financial instruments:							
Held for trading	5,337	-	-	-	-	-	5,337
Held for hedging purposes (net settled)	-	13	3	50	111	(3)	174
Trading securities	-	1,005	2,153	120	690	118	4,086
Available-for-sale securities	-	84	20	117	1,266	1,608	3,095
Loans	7,378	5,631	4,935	5,377	20,264	44,415	88,000
Life insurance assets	207	4	2	24	-	-	237
Due from related entities:							
Non-derivative balances	4	-	-	-	-	-	4
Derivative financial instruments:							
Held for trading	2,002	-	-	-	-	-	2,002
Other assets	-	384	-	-	-	-	384
Total undiscounted financial assets	**16,642**	**7,443**	**7,113**	**5,688**	**22,331**	**46,138**	**105,355**
Financial liabilities							
Due to other financial institutions	154	60	-	-	-	-	214
Deposits	19,529	5,914	7,171	9,324	2,180	-	44,118
Derivative financial instruments:							
Held for trading	4,909	-	-	-	-	-	4,909
Held for hedging purposes (net settled)	-	27	6	197	90	37	357
Held for hedging purposes (gross settled):							
Cash outflow	-	14	44	4,718	2,017	-	6,793
Cash inflow	-	(2)	(1)	(3,953)	(1,653)	-	(5,609)
Trading liabilities	518	-	-	-	-	-	518
Debt issues	-	1,026	642	3,938	7,848	259	13,713
Other liabilities	-	644	-	-	-	-	644
Subordinated debentures	-	-	-	-	-	712	712
Due to related entities:							
Non-derivative balances	4,164	70	21	1,201	975	-	6,431
Derivative financial instruments:							
Held for trading	1,605	-	-	-	-	-	1,605
Total undiscounted financial liabilities	**30,879**	**7,753**	**7,883**	**15,425**	**11,457**	**1,008**	**74,405**
Total contingent liabilities and commitments							
Loan commitments with certain drawdown	177	-	-	-	-	-	177
Other commitments to provide financial services	19,118	-	-	-	-	-	19,118
Total undiscounted contingent liabilities and commitments	**19,295**	**-**	**-**	**-**	**-**	**-**	**19,295**

Note 36 Risk management (continued)

$ millions	On Demand	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Total
	NZ Banking Group 2011						
Financial assets							
Cash and balances with central banks	1,871	-	-	-	-	-	1,871
Due from other financial institutions	670	29	-	-	-	-	699
Derivative financial instruments:							
Held for trading	5,699	-	-	-	-	-	5,699
Held for hedging purposes (net settled)	-	(5)	18	59	151	-	223
Held for hedging purposes (gross settled):							
Cash outflow	-	-	(27)	(83)	(2,896)	-	(3,006)
Cash inflow	-	-	-	73	2,787	-	2,860
Trading securities	-	752	2,282	479	1,819	1,050	6,382
Available-for-sale securities	-	1	14	118	472	1,318	1,923
Loans	4,845	2,828	5,265	6,629	22,792	47,996	90,355
Life insurance assets	162	-	11	13	-	-	186
Due from related entities:							
Non-derivative balances	10	-	-	-	-	-	10
Derivative financial instruments:							
Held for trading	2,262	-	-	-	-	-	2,262
Other assets	-	458	-	-	-	-	458
Total undiscounted financial assets	15,519	4,063	7,563	7,288	25,125	50,364	109,922
Financial liabilities							
Due to other financial institutions	658	113	5	2	-	-	778
Deposits	15,162	7,439	7,475	8,101	2,091	-	40,268
Derivative financial instruments:							
Held for trading	4,908	-	-	-	-	-	4,908
Held for hedging purposes (net settled)	-	43	25	128	128	8	332
Held for hedging purposes (gross settled):							
Cash outflow	-	7	18	102	2,087	1,508	3,722
Cash inflow	-	-	(1)	(76)	(1,691)	(1,376)	(3,144)
Trading liabilities	779	507	-	-	-	-	1,286
Debt issues	-	1,244	5,039	4,057	6,877	1,493	18,710
Other liabilities	-	1,166	-	-	-	-	1,166
Subordinated debentures	-	-	-	-	-	785	785
Due to related entities:							
Non-derivative balances	3,513	48	-	68	2,244	-	5,873
Derivative financial instruments:							
Held for trading	1,063	-	-	-	-	-	1,063
Total undiscounted financial liabilities	26,083	10,567	12,561	12,382	11,736	2,418	75,747
Total contingent liabilities and commitments							
Loan commitments with certain drawdown	164	-	-	-	-	-	164
Other commitments to provide financial services	17,336	-	-	-	-	-	17,336
Total undiscounted contingent liabilities and commitments	17,500	-	-	-	-	-	17,500

Note 36 Risk management (continued)

	NZ Branch						
	2012						
$ millions	On Demand	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Total
Financial assets							
Cash and balances with central banks	119	-	-	-	-	-	119
Derivative financial instruments:							
Held for trading	5,395	-	-	-	-	-	5,395
Held for hedging purposes (net settled)	-	15	-	11	76	-	102
Trading securities	-	655	775	85	413	66	1,994
Loans	-	90	143	79	55	29	396
Due from related entities:							
Non-derivative balances	1,151	11	1,123	638	4,229	-	7,152
Derivative financial instruments:							
Held for trading	2,945	-	-	-	-	-	2,945
Other assets	-	162	-	-	-	-	162
Total undiscounted financial assets	9,610	933	2,041	813	4,773	95	18,265
Financial liabilities							
Due to other financial institutions	151	60	-	-	-	-	211
Derivative financial instruments:							
Held for trading	5,315	-	-	-	-	-	5,315
Held for hedging purposes (gross settled):							
Cash outflow	-	7	-	21	876	-	904
Cash inflow	-	(2)	-	(5)	(652)	-	(659)
Trading liabilities	518	-	-	-	-	-	518
Other liabilities	-	122	-	-	-	-	122
Subordinated debentures	-	-	-	-	-	712	712
Due to related entities:							
Non-derivative balances	5,961	404	-	-	-	-	6,365
Derivative financial instruments:							
Held for trading	1,605	-	-	-	-	-	1,605
Total undiscounted financial liabilities	13,550	591	-	16	224	712	15,093
Total contingent liabilities and commitments							
Other commitments to provide financial services	88	-	-	-	-	-	88
Total undiscounted contingent liabilities and commitments	88	-	-	-	-	-	88

Note 36 Risk management (continued)

$ millions	On Demand	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 5 Years	Over 5 Years	Total
	NZ Branch 2011						
Financial assets							
Cash and balances with central banks	656	-	-	-	-	-	656
Derivative financial instruments:							
Held for trading	5,876	-	-	-	-	-	5,876
Held for hedging purposes (net settled)	-	-	-	11	92	-	103
Trading securities	-	170	228	57	1,617	994	3,066
Loans	510	635	889	1,434	3,469	879	7,816
Due from related entities:							
Non-derivative balances	1,404	5	11	2,190	-	-	3,610
Derivative financial instruments:							
Held for trading	2,853	-	-	-	-	-	2,853
Other assets	-	308	-	-	-	-	308
Total undiscounted financial assets	11,299	1,118	1,128	3,692	5,178	1,873	24,288
Financial liabilities							
Due to other financial institutions	558	113	5	2	-	-	678
Deposits	1,967	1,841	590	309	4	-	4,711
Derivative financial instruments:							
Held for trading	5,259	-	-	-	-	-	5,259
Held for hedging purposes (gross settled):							
Cash outflow	-	-	-	23	932	-	955
Cash inflow	-	-	-	(7)	(737)	-	(744)
Trading liabilities	779	507	-	-	-	-	1,286
Other liabilities	-	640	-	-	-	-	640
Subordinated debentures	-	-	-	-	-	785	785
Due to related entities:							
Non-derivative balances	5,180	609	-	-	-	-	5,789
Derivative financial instruments:							
Held for trading	1,064	-	-	-	-	-	1,064
Total undiscounted financial liabilities	14,807	3,710	595	327	199	785	20,423
Total contingent liabilities and commitments							
Other commitments to provide financial services	5,933	-	-	-	-	-	5,933
Total undiscounted contingent liabilities and commitments	5,933	-	-	-	-	-	5,933

36.3 Credit risk

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

Credit risk management

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

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

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

Note 36 Risk management (continued)

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

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

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

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

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

Overseas Bank Group Risk establishes and maintains group-wide credit risk management framework, policies and risk concentration limits which incorporate sound credit risk management practices, reflect approved risk appetite and strategy and meet relevant regulatory and legislative obligations. Within these boundaries the NZ Banking Group has its own credit approval limits as delegated by the Overseas Bank Group Credit Risk Officer. These establish a hierarchy of credit approval levels, aligned to customer risk grades and consistent with normal customer exposures in the business.

Credit risk mitigation, collateral and other credit enhancements

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

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

Cash and balances with central banks	These exposures are generally considered to be low risk due to the nature of the counterparties. These balances are not collateralised.
Due from other financial institutions	These exposures are mainly to relatively low risk banks (Rated A+, AA– or better). These balances are not collateralised.
Derivative financial instruments	Netting agreements are typically used to enable the effects of derivative assets and liabilities with the same counterparty to be offset when measuring these exposures. Additionally, collateralisation agreements are also typically entered into with major derivatives counterparties to avoid the potential build up of excessive mark-to-market positions.
Trading securities	These exposures are carried at fair value which reflects the credit risk. No collateral is sought directly from the issuer or counterparty.
Available-for-sale securities	Collateral is not sought directly with respect to these exposures.
Loans	Housing and other loans for consumer purposes may be secured, partially secured or unsecured depending on the product. Security is typically taken by a fixed and/or floating charge over property or other assets. Loans for business purposes may be secured, partially secured or unsecured. Security is typically taken by way of a fixed and/or floating charge over property, business assets, or other assets. Other forms of credit protection may also be sought or taken out if warranted.
Life insurance assets	These assets are carried at fair value, which reflects the credit risk. No collateral is sought directly from the issuer or counterparty.
Due from subsidiaries	These exposures are generally considered to be low risk due to the nature of the counterparties. These balances are not collateralised.
Other assets	Collateral is generally not sought on these balances except on accrued interest receivable which is assumed to follow the principal amount recorded in Loans.

Note 36 Risk management (continued)

Risk reduction

The NZ Banking Group reduces credit risk exposure to a customer through either:

- collateralisation, where the exposure is secured by eligible financial collateral; or
- formal set-off arrangements.

Collateral valuation and management

The Overseas Bank manages collateral centrally for all branches of the Overseas Bank. Westpac New Zealand manages its collateral on a stand alone basis. Exposures and collateral are revalued on a daily basis to monitor the net risk position, and formal processes are in place to ensure calls for collateral top-up or exposure reduction are made promptly. An independent operational unit has responsibility for monitoring these positions. The collaterisation arrangements are documented via the Support Annex of the International Swaps and Derivatives Association ('**ISDA**') dealing agreements.

The NZ Banking Group recognises the following as eligible collateral for credit risk mitigation by way of risk reduction:

- cash; and
- prescribed government securities.

Netting

Risk reduction by way of current account set-offs is recognised for exposures to creditworthy customers domiciled in New Zealand only. Customers are required to enter into formal agreements giving the NZ Banking Group the unfettered right to set-off gross credit and debit balances in their nominated accounts to determine the NZ Banking Group's net exposure within New Zealand.

Payment and close-out netting is undertaken for off-balance sheet financial market transactions with counterparties with whom the NZ Banking Group has entered into legally enforceable master dealing agreements which allow such netting in specified jurisdictions. Payment netting allows the NZ Banking Group to net settlements on any day to reduce cash flow exchanges between counterparties. Close-out netting effectively aggregates pre-settlement risk exposure at the time of default, thus reducing overall exposure.

Risk transfer

For mitigation by way of risk transfer, the NZ Banking Group only recognises unconditional irrevocable guarantees or standby letters of credit issued by, or eligible credit derivative protection bought from, the following entities, provided they are not related to the underlying obligor:

- sovereign entities;
- public sector entities in Australia and New Zealand;
- ADIs and overseas banks; and
- other entities with a minimum risk grade equivalent of A3 / A–.

Internal credit risk rating system

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

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

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

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

Note 36 Risk management (continued)

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

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

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

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

Use of internal credit risk estimates

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

Economic capital

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

Pricing

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

Provisioning

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

Credit approval authorities

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

Risk-adjusted performance measurement

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

Regulatory capital

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

Overview of the internal credit risk ratings process by portfolio

(a) Transaction-managed approach (including corporate, sovereign, banking, and specialised lending)

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

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

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

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

(i) PD

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

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

Note 36 Risk management (continued)

(ii) LGD

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

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

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

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

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

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

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

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

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

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

(i) PD

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

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

(ii) LGD

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

(iii) EAD

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

Market and/or credit risk concentrations

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

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

Note 36 Risk management (continued)

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

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

Foreign exchange and derivative credit risk management

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

Maximum exposure to credit risk

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Financial assets				
Cash and balances with central banks	**1,714**	1,871	**119**	656
Due from other financial institutions	**322**	699	**-**	-
Derivative financial instruments	**5,506**	6,060	**5,496**	5,976
Trading securities	**4,028**	6,065	**1,988**	2,803
Available-for-sale securities	**2,694**	1,518	**-**	-
Loans	**59,892**	58,114	**385**	6,787
Life insurance assets	**237**	186	**-**	-
Due from related entities	**2,006**	2,272	**9,685**	6,429
Other assets	**384**	458	**162**	308
Total financial assets	**76,783**	77,243	**17,835**	22,959
Contingent liabilities				
Direct credit substitutes	**335**	333	**255**	255
Loan commitments with certain drawdown	**177**	164	**-**	-
Transaction-related contingent items	**796**	700	**-**	443
Underwriting and sub-underwriting facilities	**-**	300	**-**	300
Short-term, self-liquidating trade-related contingent liabilities	**397**	443	**-**	104
Other commitments to provide financial services	**19,118**	17,336	**88**	5,933
Total contingent liabilities and commitments	**20,823**	19,276	**343**	7,035
Total maximum credit risk exposure	**97,606**	96,519	**18,178**	29,994

The NZ Banking Group's residential mortgages by loan-to-value ratio ('LVR') as at 30 September 2012

In order to calculate origination LVR, the current exposure is that used in the internal ratings based approach for mortgage lending. For loans originated from 1 January 2008, the NZ Banking Group utilises its loan origination system. For loans originated prior to 1 January 2008, the origination LVR is not separately recorded, and therefore not available for disclosure. For these loans, the NZ Banking Group utilises its dynamic LVR process to calculate an origination LVR. Exposures for which no LVR is available have been included in the 90% plus category in accordance with the requirements of the Order.

	NZ Banking Group 2012 Unaudited			
LVR Range ($ millions)	**Does not Exceed 80%**	**Exceeds 80% and not 90%**	**Exceeds 90%**	**Total**
On-balance sheet exposures	**27,264**	**5,607**	**3,022**	**35,893**
Undrawn commitments and other off-balance sheet exposures	**5,975**	**395**	**211**	**6,581**
Value of exposures	**33,239**	**6,002**	**3,233**	**42,474**

Note 36 Risk management (continued)

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

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

$ millions	NZ Banking Group 2012 Unaudited
Term loans – Housing (as disclosed in Note 13) and Residential mortgages – total gross loans (as disclosed in Note 14)	
Reconciling items:	**35,963**
Unamortised deferred fees and expenses	**(64)**
Fair value hedge adjustments	**(6)**
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	**6,581**
Residential mortgages by LVR	**42,474**

Credit quality of financial assets

The tables below segregate the financial assets of the NZ Banking Group and NZ Branch between financial assets that are neither past due nor impaired, past due but not impaired and impaired.

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

Financial assets of the NZ Banking Group as at 30 September 2012 and 2011 can be disaggregated as follows:

	NZ Banking Group 2012					
$ millions	Neither Past Due Nor Impaired	Past Due But Not Impaired	Impaired	Total	Impairment	Total carrying Value
Cash and balances with central banks	**1,714**	**-**	**-**	**1,714**	**-**	**1,714**
Due from other financial institutions	**322**	**-**	**-**	**322**	**-**	**322**
Derivative financial instruments	**5,506**	**-**	**-**	**5,506**	**-**	**5,506**
Trading securities	**4,028**	**-**	**-**	**4,028**	**-**	**4,028**
Available-for-sale securities	**2,694**	**-**	**-**	**2,694**	**-**	**2,694**
Loans	**57,872**	**1,759**	**868**	**60,499**	**(607)**	**59,892**
Life insurance assets	**237**	**-**	**-**	**237**	**-**	**237**
Due from related entities	**2,006**	**-**	**-**	**2,006**	**-**	**2,006**
Other assets	**384**	**-**	**-**	**384**	**-**	**384**
Total financial assets	**74,763**	**1,759**	**868**	**77,390**	**(607)**	**76,783**

	NZ Banking Group 2011					
$ millions	Neither Past Due Nor Impaired	Past Due But Not Impaired	Impaired	Total	Impairment	Total carrying Value
Cash and balances with central banks	1,871	-	-	1,871	-	1,871
Due from other financial institutions	699	-	-	699	-	699
Derivative financial instruments	6,060	-	-	6,060	-	6,060
Trading securities	6,065	-	-	6,065	-	6,065
Available-for-sale securities	1,518	-	-	1,518	-	1,518
Loans	55,948	1,912	919	58,779	(665)	58,114
Life insurance assets	186	-	-	186	-	186
Due from related entities	2,272	-	-	2,272	-	2,272
Other assets	458	-	-	458	-	458
Total financial assets	75,077	1,912	919	77,908	(665)	77,243

Note 36 Risk management (continued)

Financial assets of the NZ Branch as at 30 September 2012 and 2011 can be disaggregated as follows:

	NZ Branch 2012					
$ millions	**Neither Past Due Nor Impaired**	**Past Due But Not Impaired**	**Impaired**	**Total**	**Impairment**	**Total carrying Value**
Cash and balances with central banks	**119**	**-**	**-**	**119**	**-**	**119**
Derivative financial instruments	**5,496**	**-**	**-**	**5,496**	**-**	**5,496**
Trading securities	**1,988**	**-**	**-**	**1,988**	**-**	**1,988**
Loans	**385**	**-**	**1**	**386**	**(1)**	**385**
Due from related entities	**9,685**	**-**	**-**	**9,685**	**-**	**9,685**
Other assets	**162**	**-**	**-**	**162**	**-**	**162**
Total financial assets	**17,835**	**-**	**1**	**17,836**	**(1)**	**17,835**

	NZ Branch 2011					
$ millions	Neither Past Due Nor Impaired	Past Due But Not Impaired	Impaired	Total	Impairment	Total carrying Value
Cash and balances with central banks	656	-	-	656	-	656
Derivative financial instruments	5,976	-	-	5,976	-	5,976
Trading securities	2,803	-	-	2,803	-	2,803
Loans	6,707	48	125	6,880	(93)	6,787
Due from related entities	6,429	-	-	6,429	-	6,429
Other assets	308	-	-	308	-	308
Total financial assets	22,879	48	125	23,052	(93)	22,959

The following analysis shows the NZ Banking Group's assessment of the coverage provided by collateral held in support of loan balances. The estimated realisable value of collateral held is based on a combination of:

- formal valuations currently held in respect of such collateral; and
- management's assessment of the estimated realisable value of all collateral held given its experience with similar types of assets in similar situations and the circumstances peculiar to the subject collateral.

This analysis also takes into consideration any other relevant knowledge available to management at the time. It is the NZ Banking Group's practice to obtain updated valuations when either management considers that it cannot satisfactorily estimate a realisable value or when it is determined to be necessary to move to a forced sale of the collateral.

In the table below, a loan is deemed to be 'fully secured' where the ratio of the asset amount to the NZ Banking Group's current estimated net present value of the realisable collateral is less than or equal to 100%. Such assets are deemed to be 'partially secured' when this ratio exceeds 100% but not more than 150%, and 'unsecured' when either no security is held (e.g. can include credit cards, personal loans, and exposure to highly rated corporate entities) or where the secured loan to estimated recoverable value exceeds 150%.

	NZ Banking Group		NZ Branch	
%	**2012**	2011	**2012**	2011
Fully secured	**69**	68	**25**	13
Partially secured	**16**	15	**30**	10
Unsecured	**15**	17	**45**	77
Total net loans	**100**	100	**100**	100

Note 36 Risk management (continued)

Financial assets that are neither past due nor individually impaired

The credit quality of financial assets of the NZ Banking Group and NZ Branch that are neither past due nor impaired have been assessed by reference to the credit risk rating system adopted internally:

	NZ Banking Group							
	2012				2011			
$ millions	**Strong**	**Good/ Satisfactory**	**Weak**	**Total**	Strong	Good/ Satisfactory	Weak	Total
Cash and balances with central banks	**1,714**	**-**	**-**	**1,714**	1,871	-	-	1,871
Due from other financial institutions	**322**	**-**	**-**	**322**	699	-	-	699
Derivative financial instruments	**5,418**	**78**	**10**	**5,506**	5,986	63	11	6,060
Trading securities	**4,022**	**6**	**-**	**4,028**	6,065	-	-	6,065
Available-for-sale securities	**2,694**	**-**	**-**	**2,694**	1,518	-	-	1,518
Loans	**7,987**	**48,477**	**1,408**	**57,872**	8,239	46,101	1,608	55,948
Life insurance assets	**237**	**-**	**-**	**237**	186	-	-	186
Due from related entities	**2,006**	**-**	**-**	**2,006**	2,272	-	-	2,272
Other assets	**384**	**-**	**-**	**384**	458	-	-	458
Total financial assets	**24,784**	**48,561**	**1,418**	**74,763**	27,294	46,164	1,619	75,077

	NZ Branch							
	2012				2011			
$ millions	**Strong**	**Good/ Satisfactory**	**Weak**	**Total**	Strong	Good/ Satisfactory	Weak	Total
Cash and balances with central banks	**119**	**-**	**-**	**119**	656	-	-	656
Derivative financial instruments	**5,408**	**78**	**10**	**5,496**	5,902	63	11	5,976
Trading securities	**1,982**	**6**	**-**	**1,988**	2,803	-	-	2,803
Loans	**84**	**274**	**27**	**385**	5,879	634	194	6,707
Due from related entities	**9,685**	**-**	**-**	**9,685**	6,429	-	-	6,429
Other assets	**162**	**-**	**-**	**162**	308	-	-	308
Total financial assets	**17,440**	**358**	**37**	**17,835**	21,977	697	205	22,879

36.4 Market risk

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

Traded market risk

Approach

The NZ Banking Group's exposure to traded market risk arises out of its Financial Markets and Treasury trading activities. These activities are controlled by the Overseas Banking Group's market risk management framework approved by the Group BRMC. VaR is the primary mechanism for measuring and controlling market risk. Market risk is managed using VaR and structural risk limits (including volume limits and basis point value limits) in conjunction with scenario analysis and stress testing. Market risk limits are allocated to business management based upon business strategies and experience, in addition to market liquidity and concentration risks. All trades are fair valued daily, using independently sourced or reviewed rates. Rates that have limited independent sources are reviewed at least on a monthly basis.

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

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

VaR limits

Market risks arising from trading book activities are primarily measured using VaR based on historical simulation methodology. VaR is the potential loss in earnings from an adverse market movement calculated using a 99% confidence level, with a minimum of one year of historical rate data and a one-day time horizon. VaR takes account of all material market variables that may cause a change in the value of the trading portfolio, including interest rates, foreign exchange rates, price change, volatility and the correlations between these variables.

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

Backtesting

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

Note 36 Risk management (continued)

Stress testing

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

Profit and loss notification framework

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

Structure and organisation

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

Risk reporting

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

Risk mitigation

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

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

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

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

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

Approach

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

Asset and liability management

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

NII sensitivity

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

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

Limits

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

Note 36 Risk management (continued)

Risk reporting

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

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

Risk mitigation

Market risk arising in the banking book stems from the ordinary course of banking activities, including structural interest rate risk (the mismatch between the duration of assets and liabilities) and capital management. Hedging of the NZ Banking Group's exposure to interest rate risk is undertaken using derivatives. The hedge accounting strategy adopted is to utilise a combination of the cash flow, fair value and net investment hedge approaches. Some derivatives held for economic hedging purposes do not meet the criteria for hedge accounting and therefore, are accounted for in the same way as derivatives held for trading.

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

Market risk notional capital charges

The NZ Banking Group's aggregate market risk exposure is derived in accordance with the Reserve Bank document 'Capital adequacy framework (standardised approach) (BS2A)'. The peak end-of-day exposures below have been calculated by determining the maximum end-of-day aggregate market risk exposure over the six month period ended 30 September 2012. The end-of-period exposures below have been calculated by determining the end-of-day aggregate market risk as at 30 September 2012.

For each category of market risk, the peak end-of-day notional capital charge is the maximum aggregate capital charge for that category of market risk at the close of each business day derived in accordance with the Reserve Bank document 'Capital adequacy framework (standardised approach) (BS2A)'.

Market risk notional capital charges

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at balance date and the peak end-of-day notional capital charges by risk type for the six months ended 30 September 2012.

	NZ Banking Group 2012 Unaudited	
$ millions	**Implied Risk-weighted Exposure**	**Notional Capital Charge**
End-of-period		
Interest rate risk	**1,915**	**153**
Foreign currency risk	**73**	**6**
Equity risk	**70**	**6**
Peak end-of-day		
Interest rate risk	**2,274**	**182**
Foreign currency risk	**113**	**9**
Equity risk	**70**	**6**

VaR

The NZ Banking Group applies a VaR methodology to its portfolios to estimate the market risk of positions held, and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. VaR is an estimate of the potential loss in value to a 99% confidence level assuming positions were held unchanged for one day. The NZ Banking Group uses a historical simulation method to calculate VaR taking into account all material market variables. Actual outcomes are monitored and the model is back-tested daily. The use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

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

Trading

	NZ Banking Group		NZ Branch	
$ millions	**2012**	2011	**2012**	2011
Interest rate risk	**1.8**	2.1	**1.8**	2.1
Foreign exchange risk	**-**	0.7	**-**	0.7
Price risk	**-**	0.1	**-**	0.1
Volatility risk	**0.1**	0.4	**0.1**	0.4
Net market risk	**1.9**	2.2	**1.9**	2.2

Note 36 Risk management (continued)

Non-trading

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Interest rate risk	**0.5**	2.3	**1.4**	3.6

Interest rate sensitivity

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

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the NZ Banking Group's net asset position as at 30 September 2012. The NZ Banking Group uses this contractual repricing information as a base, which is then altered to take account of consumer behaviour, to manage its interest rate risk.

	NZ Banking Group 2012						
$ millions	Up to 3 Months	Over 3 Months and up to 6 months	Over 6 Months and up to 1 Year	Over 1 Year and up to 2 Years	Over 2 Years	Non-interest Bearing	Total
Financial assets							
Cash and balances with central banks	1,520	-	-	-	-	194	1,714
Due from other financial institutions	322	-	-	-	-	-	322
Derivative financial instruments	-	-	-	-	-	5,506	5,506
Trading securities	2,797	545	686	-	-	-	4,028
Available-for-sale securities	26	-	-	67	2,531	70	2,694
Loans	40,995	2,872	5,977	7,724	2,931	(607)	59,892
Life insurance assets	7	24	-	-	-	206	237
Due from related entities	-	-	-	-	-	2,006	2,006
Other assets	-	-	-	-	-	384	384
Total financial assets	45,667	3,441	6,663	7,791	5,462	7,759	76,783
Non-financial assets							1,071
Total assets							77,854
Financial liabilities							
Due to other financial institutions	209	-	-	-	-	5	214
Deposits	29,394	6,249	2,773	1,262	743	2,969	43,390
Derivative financial instruments	-	-	-	-	-	5,841	5,841
Trading liabilities	498	20	-	-	-	-	518
Debt issues	5,532	1,067	86	2,299	3,930	-	12,914
Other liabilities	-	-	-	-	-	644	644
Subordinated debentures	-	-	-	-	712	-	712
Due to related entities	6,103	-	-	-	-	1,781	7,884
Total financial liabilities	41,736	7,336	2,859	3,561	5,385	11,240	72,117
Non-financial liabilities							222
Total liabilities							72,339
Off-balance sheet financial instruments							
Net interest rate contracts (notional):							
Receivable/(payable)	(2,681)	3,247	343	(959)	50	-	-

Note 36 Risk management (continued)

$ millions	Up to 3 Months	Over 3 Months and up to 6 months	Over 6 Months and up to 1 Year	Over 1 Year and up to 2 Years	Over 2 Years	Non-interest Bearing	Total
	NZ Branch 2012						
Financial assets							
Cash and balances with central banks	**70**	**-**	**-**	**-**	**-**	**49**	**119**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**5,496**	**5,496**
Trading securities	**783**	**529**	**676**	**-**	**-**	**-**	**1,988**
Loans	**244**	**67**	**14**	**17**	**44**	**(1)**	**385**
Due from related entities	**6,697**	**-**	**-**	**-**	**-**	**2,988**	**9,685**
Other assets	**-**	**-**	**-**	**-**	**-**	**162**	**162**
Total financial assets	**7,794**	**596**	**690**	**17**	**44**	**8,694**	**17,835**
Non-financial assets							**16**
Total assets							**17,851**
Financial liabilities							
Due to other financial institutions	**206**	**-**	**-**	**-**	**-**	**5**	**211**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**5,481**	**5,481**
Trading liabilities	**498**	**20**	**-**	**-**	**-**	**-**	**518**
Other liabilities	**-**	**-**	**-**	**-**	**-**	**122**	**122**
Subordinated debentures	**-**	**-**	**-**	**-**	**712**	**-**	**712**
Due to related entities	**6,177**	**-**	**-**	**-**	**-**	**1,793**	**7,970**
Total financial liabilities	**6,881**	**20**	**-**	**-**	**712**	**7,401**	**15,014**
Non-financial liabilities							**40**
Total liabilities							**15,054**
Off-balance sheet financial instruments							
Net interest rate contracts (notional):							
Receivable/(payable)	**(3,632)**	**(779)**	**1,926**	**2,472**	**13**	**-**	**-**

Foreign currency exposures

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

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Receivable/(payable)				
Australian dollar	**-**	(42)	**-**	(42)
British pound	**-**	(1)	**-**	(1)
US dollar	**66**	110	**(3)**	60
Others	**3**	2	**3**	2

Note 37 Concentration of funding

$ millions	NZ Banking Group 2012	NZ Banking Group 2011	NZ Branch 2012	NZ Branch 2011
Funding consists of				
Due to other financial institutions	**214**	778	**211**	678
Deposits	**43,390**	39,575	**-**	4,689
Trading liabilities	**518**	1,286	**518**	1,286
Debt issues[1]	**12,914**	17,630	**-**	-
Subordinated debentures	**712**	785	**712**	785
Due to related entities[2]	**6,103**	5,545	**5,773**	5,099
Total funding	**63,851**	65,599	**7,214**	12,537
Analysis of funding by product				
Certificates of deposits	**1,423**	1,556	**-**	-
Savings accounts	**9,411**	8,469	**-**	47
Demand deposits	**7,552**	6,677	**-**	1,910
Other deposits	**1,937**	1,993	**-**	1,080
Term deposits	**23,067**	20,880	**-**	1,652
Securities sold short	**506**	779	**506**	779
Securities sold under agreements to repurchase	**12**	507	**12**	507
Debt issues	**12,914**	17,630	**-**	-
Subordinated debentures	**712**	785	**712**	785
Subtotal	**57,534**	59,276	**1,230**	6,760
Due to other financial institutions	**214**	778	**211**	678
Due to related entities[2]	**6,103**	5,545	**5,773**	5,099
Total funding	**63,851**	65,599	**7,214**	12,537
Analysis of funding by geographical areas[1]				
New Zealand	**43,118**	39,294	**2,302**	6,892
Australia	**4,860**	4,243	**3,956**	4,080
United Kingdom	**8,053**	2,557	**89**	188
United States of America	**5,195**	8,902	**741**	1,049
Other	**2,625**	10,603	**126**	328
Total funding	**63,851**	65,599	**7,214**	12,537
Analysis of funding by industry sector				
Accommodation, cafes and restaurants	**198**	171	**-**	12
Agriculture	**932**	928	**-**	9
Construction	**1,058**	911	**-**	11
Finance and insurance	**22,709**	22,507	**1,386**	5,906
Forestry and fishing	**126**	113	**-**	-
Government, administration and defence	**1,243**	953	**-**	42
Manufacturing	**1,389**	1,080	**-**	356
Mining	**73**	65	**-**	-
Property	**3,394**	2,979	**-**	111
Services	**3,923**	3,675	**-**	156
Trade	**1,194**	1,042	**-**	107
Transport and storage	**258**	250	**-**	20
Utilities	**387**	336	**-**	100
Households	**17,150**	15,663	**-**	-
Other	**3,714**	9,381	**55**	608
Subtotal	**57,748**	60,054	**1,441**	7,438
Due to related entities[2]	**6,103**	5,545	**5,773**	5,099
Total funding	**63,851**	65,599	**7,214**	12,537

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

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

Australian and New Zealand Standard Industrial Classifications have been used as the basis for disclosing industry sectors.

Note 38 Concentration of credit exposures

$ millions	NZ Banking Group 2012	2011	NZ Branch 2012	2011
On-balance sheet credit exposures consists of				
Cash and balances with central banks	**1,714**	1,871	**119**	656
Due from other financial institutions	**322**	699	**-**	-
Derivative financial instruments	**5,506**	6,060	**5,496**	5,976
Trading securities	**4,028**	6,065	**1,988**	2,803
Available-for-sale securities	**2,694**	1,518	**-**	-
Loans	**59,892**	58,114	**385**	6,787
Life insurance assets	**237**	186	**-**	-
Due from related entities	**2,006**	2,272	**9,685**	6,429
Other assets	**384**	458	**162**	308
Total on-balance sheet credit exposures	**76,783**	77,243	**17,835**	22,959
Analysis of on-balance sheet credit exposures by geographical areas				
New Zealand	**68,547**	68,471	**11,628**	16,317
Australia	**3,642**	4,255	**2,624**	3,001
United Kingdom	**2,627**	2,119	**2,627**	2,119
United States of America	**298**	707	**166**	437
Others	**1,669**	1,691	**790**	1,085
Total on-balance sheet credit exposures	**76,783**	77,243	**17,835**	22,959
Analysis of on-balance sheet credit exposures by industry sector				
Accommodation, cafes and restaurants	**557**	542	**4**	3
Agriculture	**6,437**	6,068	**73**	337
Construction	**1,447**	1,343	**6**	100
Finance and insurance	**10,990**	10,502	**5,830**	6,057
Forestry and fishing	**271**	369	**37**	227
Government, administration and defence	**5,106**	7,365	**624**	3,407
Manufacturing	**2,479**	2,351	**188**	939
Mining	**496**	299	**6**	230
Property	**9,735**	9,991	**172**	1,231
Property services and business services	**2,182**	2,017	**125**	366
Services	**2,678**	2,748	**54**	428
Trade	**3,370**	3,681	**248**	1,208
Transport and storage	**1,380**	1,452	**76**	675
Utilities	**1,695**	1,353	**383**	1,137
Retail lending	**26,125**	25,153	**-**	64
Other	**285**	347	**246**	195
Subtotal	**75,233**	75,581	**8,072**	16,604
Provisions for impairment charges on loans	**(607)**	(665)	**(1)**	(93)
Due from related entities	**2,006**	2,272	**9,685**	6,429
Other assets	**151**	55	**79**	19
Total on-balance sheet credit exposures	**76,783**	77,243	**17,835**	22,959
Off-balance sheet credit exposures				
Contingent liabilities and commitments	**20,823**	19,276	**343**	7,035
Total off-balance sheet credit exposures	**20,823**	19,276	**343**	7,035
Analysis of off-balance sheet credit exposures by industry sector				
Accommodation, cafes and restaurants	**87**	100	**-**	18
Agriculture	**564**	547	**4**	23
Construction	**426**	776	**-**	431
Finance and insurance	**2,561**	1,738	**10**	1,472
Forestry and fishing	**54**	186	**-**	135
Government, administration and defence	**926**	1,179	**21**	783
Manufacturing	**1,333**	1,368	**26**	907
Mining	**290**	351	**-**	334
Property	**1,421**	-	**-**	-
Property services and business services	**802**	2,886	**18**	797
Services	**1,064**	-	**-**	-
Trade	**1,877**	2,006	**54**	637
Transport and storage	**703**	397	**4**	235
Utilities	**1,652**	1,360	**206**	1,254
Retail lending	**6,838**	6,373	**-**	-
Other	**225**	9	**-**	9
Total off-balance sheet credit exposures	**20,823**	19,276	**343**	7,035

Australian and New Zealand Standard Industrial Classifications have been used as the basis for disclosing industry sectors.

Note 38 Concentration of credit exposures (continued)

Analysis of credit exposures to individual counterparties

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

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

- as at 30 September 2012 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2012 was nil.

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

- as at 30 September 2012 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2012 was nil.

The peak end-of-day exposures have been calculated by determining the maximum end-of-day aggregate amount of actual credit exposure over the relevant three-month period, and then dividing that amount by the Overseas Banking Group's equity as at 30 September 2012 (refer to Note 39).

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

Note 39 Other information on the Overseas Banking Group

Other information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2012.

Profitability	2012
Net profit after tax for the year ended 30 September 2012 (A$millions)	**6,036**
Net profit after tax (for the year ended 30 September 2012) as a percentage of average total assets	**0.9%**

Total assets and equity	2012
Total assets (A$millions)	**674,965**
Percentage change in total assets over the year ended 30 September 2012	**0.7%**
Total equity (A$millions)	**44,249**

Asset quality	2012
Total individually impaired assets[1, 2] (A$millions)	**3,955**
As a percentage of total assets	**0.6%**
Total individual credit impairment allowance (A$millions)	**1,470**
As a percentage of total individually impaired assets	**37.2%**
Total collective credit impairment allowance (A$millions)	**2,771**

1 Total individually impaired assets are before allowances for credit impairment loss and net of interest held in suspense.
2 Non-financial assets have not been acquired through the enforcement of security.

Note 40 Events after the reporting date

Westpac NZ Securitisation No.2 Limited was incorporated on 2 November 2012.

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Independent Auditors' Report

To the Directors of Westpac Banking Corporation

Report on the Financial Statements (excluding Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

We have audited pages 11 to 86 of the Disclosure Statement of Westpac Banking Corporation – New Zealand Branch (the '**NZ Branch**') which consists of the financial statements required by Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order (No 2) 2012 (the '**Order**') and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) required by Schedules 4, 7, 10, 11 and 13 of the Order. The financial statements comprise the balance sheets as at 30 September 2012, the income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the NZ Branch and the aggregated results of Westpac Banking Corporation New Zealand Division (the '**NZ Banking Group**').

Directors' Responsibility for the Financial Statements

The Directors of Westpac Banking Corporation (the '**Directors**') are responsible for the Disclosure Statement, which includes financial statements prepared in accordance with Clause 25 of the Order and generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 10, 11 and 13 of the Order.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) disclosed in accordance with Clause 25 and Schedules 4, 7, 10, 11 and 13 of the Order and presented to us by the Directors. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the NZ Branch and NZ Banking Group's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the NZ Branch and NZ Banking Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

We carry out other assignments on behalf of the NZ Branch and the NZ Banking Group in the areas of taxation advice and other assurance and advisory services. In addition, certain partners and employees of our firm may deal with the NZ Branch, the NZ Banking Group and Westpac Banking Corporation Group on normal terms within the ordinary course of trading activities of the NZ Branch, the NZ Banking Group and Westpac Banking Corporation Group. These matters have not impaired our independence as auditors of the NZ Branch and the NZ Banking Group. We have no other interests in the NZ Branch, the NZ Banking Group or Westpac Banking Corporation Group.

Opinion

In our opinion, the financial statements on pages 11 to 86 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 10, 11 and 13 of the Order and included within the balance sheets and Notes 14, 33, 34, 35, 36, 38 and 39):

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the NZ Branch and the NZ Banking Group as at 30 September 2012, and their financial performance and cash flows for the year then ended.

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In our opinion, the supplementary information disclosed in accordance with Schedules 4, 7, 10, 11 and 13 and included within the balance sheets and Notes 14, 33, 34, 36, 38 and 39:

(i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;

(ii) is in accordance with the books and records of the NZ Branch and NZ Banking Group; and

(iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Report on Other Legal and Regulatory Requirements (excluding Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

We also report in accordance with the requirements of Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993 and Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) for the year ended 30 September 2012:

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

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

Report on the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy

We have reviewed the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 35 and 36 of the financial statements of the NZ Branch and the NZ Banking Group for the year ended 30 September 2012.

Directors' Responsibility for the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy

The Directors are responsible for the preparation of supplementary information relating to credit and market risk exposures and capital adequacy that is prepared in accordance with the Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A) and is disclosed in accordance with Schedule 9 of the Order.

Auditors' Responsibility

Our responsibility is to express an opinion on the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 35 and 36, based on our review.

We are responsible for reviewing the disclosures in order to state whether, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the supplementary information is not, in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and

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

and for reporting our findings to you.

We conducted our review in accordance with review engagement standard RS-1 Statement of Review Engagement Standards issued in New Zealand. A review is limited primarily to enquiries of NZ Branch and NZ Banking Group personnel and analytical procedures applied to financial data, and thus provides less assurance than an audit. We have not performed an audit on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36 and, accordingly, we do not express an audit opinion on that supplementary information.

Opinion

Based on our review procedures, which are not an audit, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36, as required by Schedule 9 of the Order, is not in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and

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

Restriction on Distribution or Use

This report is made solely to the Directors, as a body. Our work has been undertaken so that we might state to the Directors those matters which we are required to state to them in an auditors' 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 NZ Branch and the Directors as a body, for our audit work, for this report, or for the opinions we have formed.

PricewaterhouseCoopers

Chartered Accountants
20 December 2012

Auckland