Westpac New Zealand Limited
Disclosure Statement

For the nine months ended 30 June 2017

Contents

General information

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

In this Disclosure Statement, reference is made to:

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

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.

Limits on material financial support by the Ultimate Parent Bank

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

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

APRA has allowed a period of five years commencing on 1 January 2016 to transition to be less than the five percent limit. Exposures for the purposes of this limit include all committed, non-intraday, non-equity exposures including derivatives and off-balance sheet exposures. Further, APRA imposed two conditions over the transition period – the percentage excess above the five percent limit as at 30 June 2015, is to reduce by at least one fifth by the end of each calendar year over the transition period, and the absolute amount of routine New Zealand non-equity exposure is not to increase from the 30 June 2015 level until the Ultimate Parent Bank is, and expects to remain, below the five percent limit. For the purposes of assessing this exposure, the five percent limit excludes equity investments and holdings of capital instruments in New Zealand banking subsidiaries. As at 30 June 2017, the ELE's non-equity exposures to New Zealand banking subsidiaries affected by the limit were approximately 5.3% of Level 1 Tier 1 capital of the Ultimate Parent Bank. Non-equity exposures would need to reduce by approximately $0.1 billion from the 30 June 2017 position to comply with the 5% limit. The Ultimate Parent Bank expects to achieve compliance with the 5% limit within the transition period.

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

Directors

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

Credit ratings

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

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

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

Guarantee arrangements

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

Conditions of registration

Non-compliance with conditions of registration

The Bank is currently undergoing a review of compliance with certain aspects of condition of registration 1B, which requires the Bank to comply with the Reserve Bank of New Zealand ('**Reserve Bank**') Capital Adequacy Framework (Internal Models Based Approach) ('**BS2B**'). On 10 February 2017 the Reserve Bank issued a notice under section 95 of the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**'), requiring the Bank to obtain an independent review of its compliance with advanced internal rating-based aspects of BS2B.

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

- It has been operating versions of the following capital models without obtaining the Reserve Bank's prior approval as required under paragraph 1.3A of the revised version of BS2B that came into effect on 1 July 2014:
  - Probability of Default ('**PD**') masterscale, Loss Given Default ('**LGD**') masterscale and expert judgment evaluation policies for transaction managed customers.
  - LGD and Exposure at Default ('**EAD**') models for credit card exposures.
  - Risk Grade model utilised within expert judgment evaluation for wholesale property development and investment customers.
  - Small business and corporate asset class definitions.
- In some instances compositional changes within the Bank's loan book were not notified to the Reserve Bank as required under paragraph 1.3A(a) of BS2B.
- For less than one percent of its residential mortgages by loan value, its use of total committed exposure rather than EAD for calculating loan-to-value ratio ('**LVR**') for capital adequacy purposes does not meet the minimum LGD requirements of paragraph 4.150 of BS2B. Additionally, for less than 5% of accounts by number, the security value utilised within the calculation of LVR is an updated valuation and not the origination value as required by that paragraph.
- It is not fully compliant with paragraph 4.246 of BS2B, as not all risk grade credit policy overrides are captured and monitored.
- For one customer, the effective maturity applied to its facilities for calculating credit risk was not compliant with paragraph 4.86A of BS2B. The calculation has now been corrected as at 30 June 2017.
- The Bank uses Australian and New Zealand Standard Industrial Classification (ANZSIC) codes to associate customers with their relevant industries and asset classes. The Bank has identified that for a small number of customers with a total EAD of approximately $1m, the wrong ANZSIC code has been used, resulting in misclassification of these exposures to the Sovereign asset class.

As disclosed in Note 14 to the financial statements, the Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk and any effect of the non-compliance with condition of registration 1B on the information relating to capital adequacy disclosed in the financial statements is not considered by the Bank to be material. Any further consequences arising from the review will be appropriately disclosed in subsequent Disclosure Statements.

Directors' statement

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

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

(b) is not false or misleading.

Each Director of the Bank believes, after due enquiry, that, over the nine months ended 30 June 2017:

(a) the Bank has complied with all conditions of registration imposed on it pursuant to section 74 of the Reserve Bank Act except as noted on page 2 and Note 14 to the financial statements;

(b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and

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

This Disclosure Statement has been signed by all the Directors:

Janice Amelia Dawson

David Alexander McLean

Malcolm Guy Bailey

Peter Francis King

Jonathan Parker Mason

Christopher John David Moller

Mary Patricia Leonie Quin

Dated this 18th day of August 2017

Income statement for the nine months ended 30 June 2017

$ millions	Note	The Banking Group Nine Months Ended 30-Jun-17 Unaudited	Nine Months Ended 30-Jun-16 Unaudited	Year Ended 30-Sep-16 Audited
Interest income		**2,922**	3,103	4,113
Interest expense		**(1,641)**	(1,800)	(2,369)
Net interest income		**1,281**	1,303	1,744
Non-interest income	2	**304**	294	400
Net operating income		**1,585**	1,597	2,144
Operating expenses		**(721)**	(681)	(907)
Impairment benefits/(charges)	3	**49**	(12)	(59)
Profit before income tax expense		**913**	904	1,178
Income tax expense		**(260)**	(251)	(327)
Profit after income tax expense		**653**	653	851

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

Statement of comprehensive income for the nine months ended 30 June 2017

$ millions	The Banking Group Nine Months Ended 30-Jun-17 Unaudited	Nine Months Ended 30-Jun-16 Unaudited	Year Ended 30-Sep-16 Audited
Profit after income tax expense	**653**	653	851
Other comprehensive income/(expense) which may be reclassified subsequently to the income statement:			
Available-for-sale securities:			
Net unrealised gains/(losses) from changes in fair value of available-for-sale securities	**13**	(15)	(21)
Income tax effect	**(4)**	4	6
Cash flow hedges:			
Net losses from changes in fair value of cash flow hedges	**(67)**	(87)	(91)
Transferred to the income statement	**62**	72	90
Income tax effect	**2**	4	(1)
Total other comprehensive income/(expense) which may be reclassified subsequently to the income statement	**6**	(22)	(17)
Other comprehensive income/(expense) which will not be reclassified subsequently to the income statement:			
Remeasurement of employee defined benefit obligations	**13**	(2)	(7)
Income tax effect	**(3)**	1	2
Total other comprehensive income/(expense) which will not be reclassified subsequently to the income statement	**10**	(1)	(5)
Total other comprehensive income/(expense), net of tax	**16**	(23)	(22)
Total comprehensive income	**669**	630	829

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

Balance sheet as at 30 June 2017

		The Banking Group		
$ millions	Note	**30-Jun-17 Unaudited**	30-Jun-16 Unaudited	30-Sep-16 Audited
Assets				
Cash and balances with central banks		**1,461**	1,825	1,418
Due from other financial institutions		**598**	521	720
Trading securities and other financial assets designated at fair value		**1,557**	1,710	2,128
Derivative financial instruments		**72**	146	130
Available-for-sale securities		**3,945**	3,777	3,790
Loans	4	**77,081**	73,802	75,172
Due from related entities		**1,260**	1,753	1,760
Investment in associate		**8**	7	9
Property and equipment		**140**	143	161
Current tax assets		**18**	44	-
Deferred tax assets		**175**	183	191
Intangible assets		**593**	591	590
Other assets		**221**	212	238
Total assets		**87,129**	84,714	86,307
Liabilities				
Due to other financial institutions		**12**	9	15
Deposits and other borrowings	7	**58,410**	57,322	58,791
Other financial liabilities at fair value through income statement	6	**301**	11	400
Derivative financial instruments		**650**	716	884
Debt issues	8	**16,786**	15,190	14,727
Current tax liabilities		**-**	-	71
Provisions		**82**	77	90
Other liabilities		**468**	492	508
Total liabilities excluding related entities liabilities		**76,709**	73,817	75,486
Due to related entities		**2,429**	3,116	3,170
Subordinated notes		**1,092**	1,090	1,091
Total related entities liabilities		**3,521**	4,206	4,261
Total liabilities		**80,230**	78,023	79,747
Net assets		**6,899**	6,691	6,560
Equity				
Share capital		**3,750**	3,750	3,750
Retained profits		**3,219**	3,022	2,886
Available-for-sale securities reserve		**10**	5	1
Cash flow hedge reserve		**(80)**	(86)	(77)
Total equity		**6,899**	6,691	6,560
Interest earning and discount bearing assets		**86,003**	83,501	85,088
Interest and discount bearing liabilities		**73,372**	71,187	72,569

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

Statement of changes in equity for the nine months ended 30 June 2017

	The Banking Group				
$ millions	Share Capital	Retained Profits	Available-for-sale Securities Reserve	Cash Flow Hedge Reserve	Total
As at 1 October 2015 (Audited)	3,750	2,700	16	(75)	6,391
Nine months ended 30 June 2016 (Unaudited)					
Profit after income tax expense	-	653	-	-	653
Net losses from changes in fair value	-	-	(15)	(87)	(102)
Income tax effect	-	-	4	24	28
Transferred to the income statement	-	-	-	72	72
Income tax effect	-	-	-	(20)	(20)
Remeasurement of employee defined benefit obligations	-	(2)	-	-	(2)
Income tax effect	-	1	-	-	1
Total comprehensive income for the nine months ended 30 June 2016	-	652	(11)	(11)	630
Transactions with owners:					
Dividends paid on ordinary shares	-	(330)	-	-	(330)
As at 30 June 2016 (Unaudited)	3,750	3,022	5	(86)	6,691
Year ended 30 September 2016 (Audited)					
Profit after income tax expense	-	851	-	-	851
Net losses from changes in fair value	-	-	(21)	(91)	(112)
Income tax effect	-	-	6	25	31
Transferred to the income statement	-	-	-	90	90
Income tax effect	-	-	-	(26)	(26)
Remeasurement of employee defined benefit obligations	-	(7)	-	-	(7)
Income tax effect	-	2	-	-	2
Total comprehensive income for the year ended 30 September 2016	-	846	(15)	(2)	829
Transactions with owners:					
Dividends paid on ordinary shares	-	(660)	-	-	(660)
As at 30 September 2016 (Audited)	3,750	2,886	1	(77)	6,560
Nine months ended 30 June 2017 (Unaudited)					
Profit after income tax expense	**-**	**653**	**-**	**-**	**653**
Net gains/(losses) from changes in fair value	**-**	**-**	**13**	**(67)**	**(54)**
Income tax effect	**-**	**-**	**(4)**	**19**	**15**
Transferred to the income statement	**-**	**-**	**-**	**62**	**62**
Income tax effect	**-**	**-**	**-**	**(17)**	**(17)**
Remeasurement of employee defined benefit obligations	**-**	**13**	**-**	**-**	**13**
Income tax effect	**-**	**(3)**	**-**	**-**	**(3)**
Total comprehensive income for the nine months ended 30 June 2017	**-**	**663**	**9**	**(3)**	**669**
Transactions with owners:					
Dividends paid on ordinary shares (refer to Note 9)	**-**	**(330)**	**-**	**-**	**(330)**
As at 30 June 2017 (Unaudited)	**3,750**	**3,219**	**10**	**(80)**	**6,899**

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

Statement of cash flows for the nine months ended 30 June 2017

	The Banking Group		
$ millions	**Nine Months Ended 30-Jun-17 Unaudited**	Nine Months Ended 30-Jun-16 Unaudited	Year Ended 30-Sep-16 Audited
Cash flows from operating activities			
Interest income received	**2,917**	3,110	4,136
Interest expense paid	**(1,646)**	(1,791)	(2,365)
Non-interest income received	**297**	274	380
Operating expenses paid	**(645)**	(601)	(797)
Income tax paid	**(337)**	(317)	(287)
Cash flows from operating activities before changes in operating assets and liabilities	**586**	675	1,067
Net decrease/(increase) in:			
Due from other financial institutions	**122**	(503)	(702)
Trading securities and other financial assets designated at fair value	**572**	371	(47)
Loans	**(1,948)**	(4,668)	(6,108)
Due from related entities	**481**	564	543
Net (decrease)/increase in:			
Due to other financial institutions	**(3)**	(481)	(475)
Deposits and other borrowings	**(381)**	4,336	5,805
Other financial liabilities at fair value through income statement	**(99)**	11	400
Other liabilities	**9**	8	(5)
Net movement in external and related entity derivative financial instruments	**(639)**	(16)	(82)
Net cash (used in)/provided by operating activities	**(1,300)**	297	396
Cash flows from investing activities			
Purchase of available-for-sale securities	**(269)**	(534)	(652)
Proceeds from maturities/sale of available-for-sale securities	**53**	200	300
Purchase of capitalised computer software	**(40)**	(31)	(46)
Purchase of property and equipment	**(13)**	(7)	(25)
Net cash used in investing activities	**(269)**	(372)	(423)
Cash flows from financing activities			
Proceeds from debt issues	**7,516**	6,968	7,840
Repayments of debt issues	**(5,270)**	(4,962)	(6,018)
Net movement in due to related entities	**(304)**	(633)	(574)
Dividends paid to ordinary shareholders	**(330)**	(330)	(660)
Net cash provided by financing activities	**1,612**	1,043	588
Net increase in cash and cash equivalents	**43**	968	561
Cash and cash equivalents at beginning of the period/year	**1,418**	857	857
Cash and cash equivalents at end of the period/year	**1,461**	1,825	1,418
Cash and cash equivalents at end of the period/year comprise:			
Cash on hand	**182**	157	204
Cash and balances with central banks	**1,279**	1,668	1,214
Cash and cash equivalents at end of the period/year	**1,461**	1,825	1,418

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

Notes to the financial statements

Note 1 Statement of accounting policies

These condensed consolidated interim financial statements ('**financial statements**') have been prepared and presented in accordance with the Order and Generally Accepted Accounting Practice in New Zealand, as appropriate for profit-oriented entities, and the New Zealand equivalent to International Accounting Standard 34 *Interim Financial Reporting* and should be read in conjunction with the Disclosure Statements for the year ended 30 September 2016 and for the six months ended 31 March 2017. These financial statements comply with International Accounting Standard 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board.

Basis of preparation

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

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 as were used in preparing the financial statements for the year ended 30 September 2016.

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

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

Note 2 Non-interest income

	The Banking Group		
$ millions	**Nine Months Ended 30-Jun-17 Unaudited**	Nine Months Ended 30-Jun-16 Unaudited	Year Ended 30-Sep-16 Audited
Fees and commissions	**302**	277	369
Net ineffectiveness on qualifying hedges	**(10)**	3	5
Other non-interest income	**12**	14	26
Total non-interest income	**304**	294	400

Note 3 Impairment charges

	The Banking Group				
$ millions	**Residential Mortgages**	**Other Retail**	**Corporate**	**Other**	**Total**
Nine months ended 30 June 2017 (Unaudited)					
Collectively assessed provisions	**7**	**(8)**	**(21)**	**-**	**(22)**
Individually assessed provisions[1]	**4**	**1**	**(52)**	**-**	**(47)**
Bad debts (recovered)/written off directly to the income statement	**(1)**	**22**	**(1)**	**-**	**20**
Total impairment charges/(benefits)	**10**	**15**	**(74)**	**-**	**(49)**
Nine months ended 30 June 2016 (Unaudited)					
Collectively assessed provisions	(9)	(6)	(9)	-	(24)
Individually assessed provisions	(2)	1	3	-	2
Bad debts written-off directly to the income statement	1	32	1	-	34
Total impairment (benefits)/charges	(10)	27	(5)	-	12
Year ended 30 September 2016 (Audited)					
Collectively assessed provisions	(12)	(8)	28	-	8
Individually assessed provisions	-	2	4	-	6
Bad debts written-off directly to the income statement	1	43	1	-	45
Total impairment (benefits)/charges	(11)	37	33	-	59

1 Corporate individually assessed provisions reduced during the reporting period as a result of recoveries of amounts previously impaired, which exceeded recovery expectations.

Note 4 Loans

$ millions	The Banking Group 30-Jun-17 Unaudited	30-Jun-16 Unaudited	30-Sep-16 Audited
Overdrafts	**1,182**	1,220	1,313
Credit card outstandings	**1,487**	1,535	1,503
Money market loans	**1,424**	1,456	1,362
Term loans:			
Housing	**46,791**	44,654	45,153
Non-housing	**25,653**	24,486	25,425
Other	**927**	852	851
Total gross loans	**77,464**	74,203	75,607
Provisions for impairment charges	**(383)**	(401)	(435)
Total net loans	**77,081**	73,802	75,172

As at 30 June 2017, $6,452 million of housing loans were used by the Banking Group to secure the obligations of Westpac Securities NZ Limited ('**WSNZL**') under the Bank's Global Covered Bond Programme ('**CB Programme**') (30 June 2016: $7,089 million, 30 September 2016: $6,591 million). These housing loans were not derecognised from the Banking Group's balance sheet in accordance with the accounting policies outlined in Note 1 to the financial statements included in the Disclosure Statement for the year ended 30 September 2016. As at 30 June 2017, the New Zealand dollar equivalent of bonds issued by WSNZL under the CB Programme was $4,996 million (30 June 2016: $3,524 million, 30 September 2016: $3,480 million).

Note 5 Asset quality

$ millions	The Banking Group 30-Jun-17 (Unaudited) Residential Mortgages	Other Retail	Corporate	Other	Total
Assets at least 90 days past due but not impaired	**57**	**20**	**10**	**-**	**87**
Individually impaired assets	**31**	**4**	**139**	**-**	**174**
Individually assessed provisions	**9**	**3**	**43**	**-**	**55**
Collectively assessed provisions	**55**	**96**	**209**	**-**	**360**

Note 6 Financial assets pledged as collateral

The Banking Group is required to provide collateral to other financial institutions, as part of standard terms, to secure liabilities. In addition to assets supporting the CB Programme (refer to Note 4), the carrying value of these financial assets pledged as collateral is:

$ millions	The Banking Group 30-Jun-17 Unaudited	30-Jun-16 Unaudited	30-Sep-16 Audited
Cash	**593**	521	720
Securities pledged under repurchase agreements			
Available-for-sale securities[1]	**306**	59	483
Trading securities and other financial assets designated at fair value	**-**	-	-
Total amount pledged to secure liabilities (excluding CB Programme)	**899**	580	1,203

[1] As at 30 June 2017, $5 million of available-for-sale securities were pledged as collateral to the New Zealand Branch of the Ultimate Parent Bank (30 June 2016: $59 million, 30 September 2016: $83 million) which is recorded within due to related entities and $301 million was pledged to third parties (30 June 2016: nil, 30 September 2016: $400 million) which is recorded as other financial liabilities at fair value through income statement.

Note 7 Deposits and other borrowings

$ millions	The Banking Group 30-Jun-17 Unaudited	30-Jun-16 Unaudited	30-Sep-16 Audited
Certificates of deposit	**770**	1,461	1,250
Non-interest bearing, repayable at call	**5,188**	4,637	4,621
Other interest bearing:			
At call	**23,332**	25,299	23,741
Term	**29,120**	25,925	29,179
Total deposits and other borrowings	**58,410**	57,322	58,791

Deposits and other borrowings have been prepared under both the historical cost convention and by applying fair value accounting to certain products. Refer to Note 10 for further details.

Note 8 Debt issues

$ millions	The Banking Group 30-Jun-17 Unaudited	30-Jun-16 Unaudited	30-Sep-16 Audited
Short-term debt			
Commercial paper	**2,081**	2,305	2,410
Total short-term debt	**2,081**	2,305	2,410
Long-term debt			
Non-domestic medium-term notes	**6,193**	5,793	5,616
Covered bonds	**4,996**	3,524	3,480
Domestic medium-term notes	**3,516**	3,568	3,221
Total long-term debt	**14,705**	12,885	12,317
Total debt issues	**16,786**	15,190	14,727
Movement in debt issues			
Balance at beginning of the period/year	**14,727**	14,685	14,685
Issuance during the period/year	**7,516**	6,968	7,840
Repayments during the period/year	**(5,270)**	(4,962)	(6,018)
Effect of foreign exchange movements during the period/year	**(53)**	(1,556)	(1,824)
Effect of fair value movements and amortisation adjustments during the period/year	**(134)**	55	44
Balance at end of the period/year	**16,786**	15,190	14,727

Debt issues have been prepared under both the historical cost convention and by applying fair value accounting to certain products. Refer to Note 10 for further details.

Note 9 Related entities

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

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

In May 2017, the Banking Group repaid $200 million funding owing to the New Zealand Branch of the Ultimate Parent Bank ('**NZ Branch'**).

Note 10 Fair value of financial instruments

Fair valuation control framework

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

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

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

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

Note 10 Fair value of financial instruments (continued)

Fair value hierarchy

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

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

Valuation techniques

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

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

Financial instruments measured at fair value

Level 1 instruments

The fair value of financial instruments traded in active markets based on recent unadjusted quoted prices. These prices are based on actual arm's length basis transactions.

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

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

Level 2 instruments

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

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

Instrument	Balance sheet category	Includes:	Valuation
Interest rate products	Derivative financial instruments Due from related entities Due to related entities	Interest rate swaps – derivative financial instruments	Industry standard valuation models are used to calculate the expected future value of payments by product, which is discounted back to a present value. The model's interest rate inputs are benchmark interest rates and active broker quoted interest rates in the swap, bond and futures markets. Interest rate volatilities are sourced from brokers and consensus data providers.
Foreign exchange products	Derivative financial instruments Due from related entities Due to related entities	FX swaps, FX forward contracts and FX options – derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
Non-asset backed debt instruments	Trading securities and other financial assets designated at fair value Available-for-sale securities Due from related entities Other financial liabilities at fair value through income statement Due to related entities	Local authority and NZ public securities, other bank issued certificates of deposit, commercial paper, other government securities and corporate bonds Security repurchase agreements and reverse repurchase agreements over non-asset backed debt securities with related and third parties	Valued using observable market prices which are sourced from consensus pricing services, broker quotes or inter-dealer prices.
Certificates of deposit	Deposits and other borrowings	Certificates of deposit	Discounted cash flow using market rates offered for deposits of similar remaining maturities.
Debt issues at fair value	Debt issues	Debt issues	Discounted cash flows, using a discount rate which reflects the terms of the instrument and the timing of cash flows adjusted for market observable changes in the Bank's implied credit worthiness.

Note 10 Fair value of financial instruments (continued)

Level 3 instruments

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

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

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

	The Banking Group 30-Jun-17 (Unaudited)			
$ millions	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value on a recurring basis				
Trading securities and other financial assets designated at fair value	**216**	**1,341**	**-**	**1,557**
Derivative financial instruments	**-**	**72**	**-**	**72**
Available-for-sale securities	**1,566**	**2,379**	**-**	**3,945**
Due from related entities	**-**	**73**	**-**	**73**
Total financial assets carried at fair value	**1,782**	**3,865**	**-**	**5,647**
Financial liabilities measured at fair value on a recurring basis				
Deposits at fair value	**-**	**770**	**-**	**770**
Other financial liabilities at fair value through income statement	**-**	**301**	**-**	**301**
Derivative financial instruments	**-**	**650**	**-**	**650**
Debt issues at fair value	**-**	**2,081**	**-**	**2,081**
Due to related entities	-	**461**	**-**	**461**
Total financial liabilities carried at fair value	**-**	**4,263**	**-**	**4,263**

	The Banking Group 30-Jun-16 (Unaudited)			
$ millions	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value on a recurring basis				
Trading securities and other financial assets designated at fair value	279	1,431	-	1,710
Derivative financial instruments	-	146	-	146
Available-for-sale securities	1,617	2,160	-	3,777
Due from related entities	-	546	-	546
Total financial assets carried at fair value	1,896	4,283	-	6,179
Financial liabilities measured at fair value on a recurring basis				
Deposits at fair value	-	1,461	-	1,461
Other financial liabilities at fair value through income statement	-	11	-	11
Derivative financial instruments	-	716	-	716
Debt issues at fair value	-	2,305	-	2,305
Due to related entities	-	1,004	-	1,004
Total financial liabilities carried at fair value	-	5,497	-	5,497

	The Banking Group 30-Sep-16 (Audited)			
$ millions	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value on a recurring basis				
Trading securities and other financial assets designated at fair value	478	1,650	-	2,128
Derivative financial instruments	-	130	-	130
Available-for-sale securities	1,608	2,182	-	3,790
Due from related entities	-	478	-	478
Total financial assets carried at fair value	2,086	4,440	-	6,526
Financial liabilities measured at fair value on a recurring basis				
Deposits at fair value	-	1,250	-	1,250
Other financial liabilities at fair value through income statement	-	400	-	400
Derivative financial instruments	-	884	-	884
Debt issues at fair value	-	2,410	-	2,410
Due to related entities	-	979	-	979
Total financial liabilities carried at fair value	-	5,923	-	5,923

Analysis of movements between fair value hierarchy levels

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

Note 10 Fair value of financial instruments (continued)

Financial instruments not measured at fair value

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

	The Banking Group					
	30-Jun-17 (Unaudited)		30-Jun-16 (Unaudited)		30-Sep-16 (Audited)	
$ millions	**Total Carrying Amount**	**Estimated Fair Value**	Total Carrying Amount	Estimated Fair Value	Total Carrying Amount	Estimated Fair Value
Financial assets not measured at fair value						
Loans	**77,081**	**77,087**	73,802	74,090	75,172	75,417
Total financial assets	**77,081**	**77,087**	73,802	74,090	75,172	75,417
Financial liabilities not measured at fair value						
Deposits and other borrowings	**57,640**	**57,682**	55,861	55,927	57,541	57,597
Debt issues	**14,705**	**14,856**	12,885	13,018	12,317	12,473
Due to related entities	**1,968**	**1,984**	2,112	2,112	2,191	2,210
Subordinated notes	**1,092**	**1,140**	1,090	1,066	1,091	1,111
Total financial liabilities	**75,405**	**75,662**	71,948	72,123	73,140	73,391

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

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

Note 11 Credit related commitments and contingent liabilities

	The Banking Group		
$ millions	**30-Jun-17 Unaudited**	30-Jun-16 Unaudited	30-Sep-16 Audited
Letters of credit and guarantees	**762**	814	818
Commitments to extend credit	**24,304**	24,548	23,932
Other commitments	**24**	-	-
Total undrawn credit commitments	**25,090**	25,362	24,750

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

As disclosed on page 2, on 10 February 2017 the Reserve Bank issued a notice under section 95 of the Reserve Bank Act, requiring the Bank to obtain an independent review of its compliance with advanced internal rating-based aspects of BS2B. The review has commenced and the Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital at 30 June 2017. Any further consequences arising from the section 95 review will be appropriately disclosed in subsequent Disclosure Statements.

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

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

Note 12 Segment information

The Banking Group operates predominantly in the consumer banking and wealth, commercial, corporate and institutional banking, and investments and insurance sectors within New Zealand. On this basis, no geographical segment information is provided.

The operating segment results have been presented on a management reporting basis and consequently internal charges and transfer pricing adjustments have been reflected in the performance of each operating segment. Intersegment pricing is determined on a cost recovery basis.

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

Comparative information for the nine months ended 30 June 2016 and the year ended 30 September 2016 has been restated following customer segmentation changes, as well as changes to the net interest income in the operating segments, as a result of the Ultimate Parent Bank updating its capital allocation framework. Comparative information has been restated to ensure consistent presentation with the current reporting period. The revised presentation has no impact on total profit before income tax expense for the nine months ended 30 June 2016 and the year ended 30 September 2016.

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

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

Notes to the financial statements

Note 12 Segment information (continued)

Reconciling items primarily represent:

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

	The Banking Group				
$ millions	Consumer Banking and Wealth	Commercial, Corporate and Institutional	Investments and Insurance	Reconciling Items	Total
Nine months ended 30 June 2017 (Unaudited)					
Net interest income	**784**	**503**	**1**	**(7)**	**1,281**
Non-interest income	**168**	**113**	**98**	**(75)**	**304**
Net operating income	**952**	**616**	**99**	**(82)**	**1,585**
Net operating income from external customers	**1,305**	**851**	**102**	**(673)**	**1,585**
Net internal interest expense	**(353)**	**(235)**	**(3)**	**591**	**-**
Net operating income	**952**	**616**	**99**	**(82)**	**1,585**
Operating expenses	**(537)**	**(167)**	**(21)**	**4**	**(721)**
Impairment (charges)/benefits	**(27)**	**76**	**-**	**-**	**49**
Profit before income tax expense	**388**	**525**	**78**	**(78)**	**913**
Total gross loans	**44,401**	**33,028**	**-**	**35**	**77,464**
Total deposits and other borrowings	**33,876**	**23,765**	**-**	**769**	**58,410**
Nine months ended 30 June 2016 (Unaudited)					
Net interest income/(expense)	768	521	(3)	17	1,303
Non-interest income	146	105	96	(53)	294
Net operating income	914	626	93	(36)	1,597
Net operating income from external customers	1,277	891	97	(668)	1,597
Net internal interest expense	(363)	(265)	(4)	632	-
Net operating income	914	626	93	(36)	1,597
Operating expenses	(509)	(164)	(19)	11	(681)
Impairment (charges)/benefits	(25)	13	-	-	(12)
Profit before income tax expense	380	475	74	(25)	904
Total gross loans	42,194	31,950	-	59	74,203
Total deposits and other borrowings	32,604	23,257	-	1,461	57,322
Year ended 30 September 2016 (Unaudited)					
Net interest income/(expense)	1,032	700	(4)	16	1,744
Non-interest income	195	142	128	(65)	400
Net operating income	1,227	842	124	(49)	2,144
Net operating income from external customers	1,718	1,186	129	(889)	2,144
Net internal interest expense	(491)	(344)	(5)	840	-
Net operating income	1,227	842	124	(49)	2,144
Operating expenses	(672)	(219)	(26)	10	(907)
Impairment charges	(32)	(15)	-	(12)	(59)
Profit before income tax expense	523	608	98	(51)	1,178
Total gross loans	42,695	32,851	-	61	75,607
Total deposits and other borrowings	32,830	24,711	-	1,250	58,791

Note 13 Insurance business

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

Note 14 Capital adequacy

The information contained in this note has been derived in accordance with the Bank's conditions of registration which relate to capital adequacy and BS2B issued by the Reserve Bank, except for the matters of non-compliance with condition of registration 1B disclosed on page 2. The Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk and any effect of the non-compliance with its conditions of registration 1B on the information relating to capital adequacy is not considered by the Bank to be material.

The Banking Group's capital summary (Unaudited)

$ millions	The Banking Group 30-Jun-17
Tier 1 capital	
Common Equity Tier 1 capital	**6,899**
Less deductions from Common Equity Tier 1 capital	**(900)**
Total Common Equity Tier 1 capital [1]	**5,999**
Additional Tier 1 capital	**-**
Total Tier 1 capital	**5,999**
Tier 2 capital	**1,092**
Total capital	**7,091**

[1] Common Equity Tier 1 capital includes available-for-sale securities reserve and cash flow hedge reserve as disclosed in the balance sheet.

Capital ratios (Unaudited)

The table below is disclosed under the Reserve Bank's Basel III framework in accordance with Clause 1 of Schedule 12 to the Order and represents the capital adequacy calculation based on BS2B.

%	The Banking Group 30-Jun-17	Reserve Bank Minimum Ratios
Common Equity Tier 1 capital ratio	**11.3**	4.5
Tier 1 capital ratio	**11.3**	6.0
Total capital ratio	**13.3**	8.0
Buffer ratio	**5.3**	2.5

The Banking Group Pillar 1 total capital requirement (Unaudited)

$ millions	The Banking Group 30-Jun-17
Credit risk	
Exposures subject to the internal ratings based approach:	
Residential mortgages	**1,337**
Other retail (credit cards, personal loans, personal overdrafts)	**224**
Small business	**58**
Corporate/Business lending	**1,575**
Sovereign	**10**
Bank	**17**
Total exposures subject to the internal ratings based approach	**3,221**
Exposures not subject to the internal ratings based approach:	
Specialised lending subject to the slotting approach	**544**
Exposures subject to the standardised approach	**62**
Total exposures not subject to the internal ratings based approach	**606**
Total credit risk (scaled)[1]	**3,827**
Operational risk	**362**
Market risk	**72**
Total	**4,261**

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

Capital for other material risks (Unaudited)

The Banking Group's internal capital adequacy assessment process identifies, reviews and measures additional material risks that must be captured within the Banking Group's capital adequacy assessment process. The additional material risks considered are those not captured by Pillar 1 regulatory capital requirements and include compliance risk, conduct risk, liquidity risk, reputational risk, environmental, social and governance risk, business/strategic risk, other assets risk, model risk and subsidiary risk. As at 30 June 2017, the Banking Group's internal capital allocation for 'other material risks' was $81 million.

Note 15 Risk management

15.1 Credit risk

The Banking Group's residential mortgages by LVR as at 30 June 2017 (Unaudited)

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

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

For loans approved but not yet drawn in reporting periods prior to and including 31 December 2016, exposures were not separately recorded and are therefore not available for disclosure. As at 30 June 2017, loans approved but not yet drawn utilise the proposed loan limit to calculate LVR and are included in the relevant LVR range.

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

	The Banking Group 30-Jun-17					
LVR range ($ millions)	Does not exceed 60%	Exceeds 60% and not 70%	Exceeds 70% and not 80%	Exceeds 80% and not 90%	Exceeds 90%	Total
On-balance sheet exposures	18,460	11,332	12,503	2,659	1,622	46,576
Undrawn commitments and other off-balance sheet exposures	4,727	1,258	977	130	184	7,276
Value of exposures	**23,187**	**12,590**	**13,480**	**2,789**	**1,806**	**53,852**

15.2 Liquidity risk

Liquid assets (Unaudited)

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

$ millions	The Banking Group 30-Jun-17
Cash and balances with central banks	1,461
Due from other financial institutions (included in due from related entities)	457
Supranational securities	1,554
NZ Government securities	1,656
NZ public securities	1,468
NZ corporate securities	520
Residential mortgage-backed securities	3,950
Total liquid assets	**11,066**

Note 16 Concentration of credit exposures to individual counterparties

Unaudited

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

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

- as at 30 June 2017 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 June 2017 was nil.

Note 16 Concentration of credit exposures to individual counterparties (continued)

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

	The Banking Group
	30-Jun-17
	Long-term credit rating
% of Banking Group's equity	A- or A3 and above
As at 30 June 2017[1]	
10-14	-
15-19	-
20 and above	1
Peak end-of-day aggregate credit exposure for the three months ended 30 June 2017[1]	
10-14	-
15-19	-
20 and above	1

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

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

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

Note 17 Events after the reporting date

On 18 August 2017, the Board resolved that an unimputed dividend of $310 million on the ordinary shares on issue be paid by the Bank to its immediate parent company, Westpac New Zealand Group Limited.