Bank of New Zealand

Disclosure Statement

For the year ended 30 September 2018

No. 90

Disclosure Statement

For the year ended 30 September 2018

This Disclosure Statement has been issued by Bank of New Zealand for the year ended 30 September 2018 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order").

In this Disclosure Statement, unless the context otherwise requires:

a) "Banking Group" means Bank of New Zealand's financial reporting group, which consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes; and

b) Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

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Bank of New Zealand Corporate Information

Address for Service

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

Nature of Business

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

Voting Securities and Power to Appoint Directors

National Australia Group (NZ) Limited ("NAGNZ"), National Australia Bank Limited and National Equities Limited are the only holders of a direct or indirect qualifying interest in the 4,475,997,499 voting securities of the Bank. NAGNZ is the registered and beneficial holder of 4,475,997,499 voting securities and therefore holds 100% of the direct interest in the voting securities. Neither National Australia Bank Limited (the ultimate parent company) nor National Equities Limited (the immediate parent company of NAGNZ) is the registered or the beneficial holder of any of the voting securities of the Bank, but each has a relevant interest in all such securities by virtue of NAGNZ being related to them in terms of section 237(d) and 12(2) of the Financial Markets Conduct Act 2013 ("FMCA") due to the fact that National Equities Limited owns 100% of the voting securities in NAGNZ and National Australia Bank Limited owns 100% of the voting securities in National Equities Limited.

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

Guarantees

Covered bond guarantee

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

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

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

Refer to note 11 for further information.

Other material obligations of the Bank are not guaranteed.

Ultimate Parent Bank

Ultimate Parent Bank and Address for Service

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

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

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

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

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

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

Bank of New Zealand Corporate Information

Ultimate Parent Bank *continued*

APRA has confirmed that during ordinary times, National Australia Bank Limited's non-equity exposures to the Bank must be below 5% of National Australia Bank Limited's Level One Tier One Capital. Exposures subject to this 5% limit include all committed, non-intraday, non-equity exposures, including derivatives and off-balance sheet exposures. As at 30 September 2018, National Australia Bank Limited's non-equity exposures to the Bank are below 5% of National Australia Bank Limited's Level One Tier One Capital.

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

Pending Proceedings or Arbitration

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

Other Matters

The Bank's Directors are of the opinion that there are no other matters relating to the business or affairs of the Registered Bank or the Banking Group which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the Registered Bank or any member of the Banking Group is the issuer.

In May 2018, the RBNZ and the Financial Markets Authority ("FMA") initiated a review of conduct and culture in the New Zealand banking industry. As part of this review, the RBNZ and the FMA published a report on 5 November 2018 which included a number of industry-wide recommendations for effectively identifying, managing, remediating and reporting on conduct risks and issues. In late November 2018, the RBNZ and the FMA provided individual New Zealand banks (including the Bank) with specific findings and recommendations, with a requirement that those banks deliver an action plan by the end of March 2019 to address the findings. The final outcome of the RBNZ's and the FMA's review may lead to further increased political or regulatory scrutiny of the banking industry in New Zealand, and could adversely impact the reputation, operations and financial performance and position of the Bank.

Directorate and Auditor

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

Directors

Angela Mentis was appointed as Managing Director and Chief Executive Officer of the Bank, effective 1 January 2018.

Anthony John Healy resigned as Managing Director and Chief Executive Officer of the Bank, effective 1 January 2018.

Directors' details

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

Non-Executive Director, Chairman

Douglas Alexander McKay, ONZM
Primary Occupation: Company Director
B.A. (Auckland), A.M.P. (Harvard Business School)
New Zealand

Other Directorships:
Fletcher Building Industries Limited, Fletcher Building Limited, Genesis Energy Limited, IAG New Zealand Limited, IAG (NZ) Holdings Limited, National Australia Bank Limited, Tourism Transport Limited, Wymac Consulting Limited, Chairman of the Eden Park Trust Board.

Executive Director

Angela Mentis
Primary Occupation: Managing Director and Chief Executive Officer
Other Occupation: Company Director
BBus, GDip Applied Finance, GAICD
New Zealand

Other Directorships:
Banking Ombudsman Scheme Limited, Loyalty New Zealand Limited.

Bank of New Zealand Corporate Information

Directorate and Auditor *continued*

Independent Non-Executive Directors

Mai Chen
Primary Occupation: Barrister and Solicitor
Other Occupation: Company Director
LL.B (Hons.) (Otago), LL.M (Harvard), FNZIM
New Zealand

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

Prudence Mary Flacks
Primary Occupation: Company Director
LL.B., LL.M.
New Zealand

Other Directorships:
Chorus Limited, Chorus LTI Trustee Limited, Chorus New Zealand Limited, Mercury LTI Limited, Mercury NZ Limited, Planboe Limited, Chair of Queenstown Airport Corporation Limited.

Bruce Ronald Hassall
Primary Occupation: Company Director
B.Com., FCA
New Zealand

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

Louis Arthur Hawke
Primary Occupation: Company Director
BEc (Hons), MBA
Australia

Other Directorships:
Chairman of BNZ Insurance Services Limited, Chairman of BNZ Life Insurance Limited, Hawke Business Associates Pty Limited, Hawke Family Pty Limited, VendorPanel Pty Limited.

Kevin John Kenrick
Primary Occupation: Chief Executive Officer of Television New Zealand Limited
Other Occupation: Company Director
BMS
New Zealand

Other Directorships:
Freeview Television Limited, NZOOM Limited, TVNZ International Limited, TVNZ Investments Limited, Chairman of Good George Brewing Advisory Board.

Non-Executive Directors

Philip Wayne Chronican
Primary Occupation: Company Director
B.Com (Hons.), MBA (Dist.), GAICD, SF Fin.
Australia

Other Directorships:
Banking + Finance Oath, Chronican Superannuation Fund No 2, Pty Limited, JDRF Australia, Meribel Pty Limited, National Australia Bank Limited, Talloires Pty Limited, Chairman of NSW Treasury Corporation.

Diversity

As at 30 September 2018, the proportions of female Directors on the Board and female members as the Bank's Officers were 38% and 30%, respectively (30 September 2017: 33% and 11%).

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

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

New Zealand Regional Audit Committee

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

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

Bank of New Zealand Corporate Information

Directorate and Auditor *continued*

Responsible Persons

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

Mai Chen
Philip Wayne Chronican
Prudence Mary Flacks
Bruce Ronald Hassall
Louis Arthur Hawke
Kevin John Kenrick

Policy for Avoiding and Dealing with Conflicts of Interests

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

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

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

Directors' Benefits

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

Information pertaining to loans to and other transactions with Directors is disclosed in note 23 of this Disclosure Statement.

Auditor

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

Financial Statements

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Historical Summary of Financial Statements

Dollars in Millions	Consolidated 30/9/18	30/9/17	30/9/16	30/9/15	30/9/14
Income statement					
Interest income	**4,055**	3,843	3,854	4,247	3,926
Interest expense	**2,109**	2,049	2,097	2,512	2,302
Net interest income	**1,946**	1,794	1,757	1,735	1,624
Gains less losses on financial instruments	**191**	118	106	322	69
Other operating income	**419**	403	406	375	443
Total operating income	**2,556**	2,315	2,269	2,432	2,136
Operating expenses	**1,045**	932	889	865	901
Total operating profit before credit impairment charge and income tax expense	**1,511**	1,383	1,380	1,567	1,235
Credit impairment charge	**82**	83	120	128	74
Total operating profit before income tax expense	**1,429**	1,300	1,260	1,439	1,161
Income tax expense on operating profit	**400**	363	347	401	311
Net profit attributable to shareholders of Bank of New Zealand	**1,029**	937	913	1,038	850
Dividends					
Ordinary dividend	**620**	700	500	345	420
Ordinary dividend reinvested as ordinary shares[1]	**1,105**	-	-	-	-
Total ordinary dividend	**1,725**	700	500	345	420
Perpetual preference dividend	**-**	3	32	32	44
Significant balance sheet items					
Total assets	**99,991**	95,315	92,541	86,787	79,685
Total liabilities	**92,612**	88,374	85,536	79,745	73,944
Ordinary shareholder's equity[1]	**7,379**	6,941	6,805	6,392	5,091
Contributed equity - perpetual preference shareholders	**-**	-	200	650	650
Asset quality					
Individually impaired assets - at amortised cost	**248**	222	246	214	263
Individually impaired assets - at fair value through profit or loss	**17**	28	7	1	14
Credit impairment charge charged to income statement - at amortised cost	**82**	83	120	128	74
Credit risk adjustments on financial assets charged to income statement - at fair value through profit or loss (including derivatives)	**(14)**	(18)	7	15	39

[1] On 8 December 2017, the Board of the Bank resolved that the Bank pay dividends of $1.405 billion on its ordinary shares. Effected on the same date, the Board of the Bank also approved the issuance of 1.105 billion ordinary shares to NAGNZ at a subscription price of $1.00 per share. This resulted in a net payment to NAGNZ of $300 million. On 14 June 2018, the Board of the Bank resolved that the Bank pay dividends of $0.320 billion on its ordinary shares.

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

Basel III regulatory capital ratios

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

	Consolidated Unaudited 30/9/18	Unaudited[2] 30/9/17	Unaudited[2] 30/9/16	Unaudited[2] 30/9/15	Unaudited[2] 30/9/14
Common Equity Tier One capital ratio	**10.56%**	10.38%	9.98%	10.44%	9.15%
Tier One capital ratio	**11.95%**	11.83%	10.30%	11.40%	10.39%
Total qualifying capital ratio	**13.59%**	13.02%	11.77%	12.36%	11.76%
Buffer ratio	**5.59%**	5.02%	3.77%	4.36%	3.76%

[2] Comparative data for the Banking Group's capital ratios has been restated due to a data error in the Banking Group's unutilised credit limit.

Income Statement

For the year ended 30 September 2018

		Consolidated	
Dollars in Millions	Note	30/9/18	30/9/17
Interest income	2	**4,055**	3,843
Interest expense	2	**2,109**	2,049
Net interest income		**1,946**	1,794
Gains less losses on financial instruments	3	**191**	118
Other operating income	4	**419**	403
Total operating income		**2,556**	2,315
Operating expenses	5	**1,045**	932
Total operating profit before credit impairment charge and income tax expense		**1,511**	1,383
Credit impairment charge	12	**82**	83
Total operating profit before income tax expense		**1,429**	1,300
Income tax expense on operating profit	7	**400**	363
Net profit attributable to shareholders of Bank of New Zealand		**1,029**	937

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

Statement of Comprehensive Income

For the year ended 30 September 2018

		Consolidated	
Dollars in Millions	Note	30/9/18	30/9/17
Net profit attributable to shareholders of Bank of New Zealand		**1,029**	937
Other comprehensive income/(expense):			
Items that will not be reclassified to profit or loss			
Movement in asset revaluation reserve		**-**	1
Credit risk adjustments on financial liabilities designated at fair value through profit or loss		**60**	(48)
Tax on items transferred directly to/(from) equity		**(17)**	13
		43	(34)
Items that may be reclassified subsequently to profit or loss			
Movement in cash flow hedge reserve	14	**-**	(64)
Tax on cash flow hedge reserve		**(14)**	-
		(14)	(64)
Total other comprehensive income/(expense)		**29**	(98)
Total comprehensive income attributable to shareholders of Bank of New Zealand		**1,058**	839

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

Statement of Changes in Equity

For the year ended 30 September 2018

Dollars in Millions	Ordinary Capital	Perpetual Preference Capital	Retained Profits	Asset Revaluation Reserve	Cash Flow Hedge Reserve	Total Share-holders' Equity
	Consolidated (30/9/18)					
Balance at beginning of year	**2,351**	**-**	**4,538**	**3**	**49**	**6,941**
Comprehensive income/(expense)						
Net profit attributable to shareholder of Bank of New Zealand	**-**	**-**	**1,029**	**-**	**-**	**1,029**
Credit risk adjustments on financial liabilities designated at fair value through profit or loss	**-**	**-**	**60**	**-**	**-**	**60**
Tax effect on items directly recognised in equity	**-**	**-**	**(17)**	**-**	**(14)**	**(31)**
Total comprehensive income/(expense)	**-**	**-**	**1,072**	**-**	**(14)**	**1,058**
Proceeds from shares issued[1]	**1,105**	**-**	**-**	**-**	**-**	**1,105**
Ordinary dividend[1]	**-**	**-**	**(1,725)**	**-**	**-**	**(1,725)**
Balance at end of year	**3,456**	**-**	**3,885**	**3**	**35**	**7,379**
	Consolidated (30/9/17)					
Balance at beginning of year	2,351	200	4,339	2	113	7,005
Comprehensive income/(expense)						
Net profit attributable to shareholders of Bank of New Zealand	-	-	937	-	-	937
Credit risk adjustments on financial liabilities designated at fair value through profit or loss	-	-	(48)	-	-	(48)
Reserve movement through other comprehensive income	-	-	-	1	(64)	(63)
Tax effect on items directly recognised in equity	-	-	13	-	-	13
Total comprehensive income/(expense)	-	-	902	1	(64)	839
Buyback of shares	-	(200)	-	-	-	(200)
Ordinary dividend	-	-	(700)	-	-	(700)
Perpetual preference dividend	-	-	(3)	-	-	(3)
Balance at end of year	2,351	-	4,538	3	49	6,941

[1] On 8 December 2017, the Bank paid dividends of $1.405 billion on its ordinary shares and issued 1.105 billion ordinary shares.

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

Balance Sheet

As at 30 September 2018

Dollars in Millions	Note	Consolidated 30/9/18	30/9/17
Assets			
Cash and liquid assets	8	**2,489**	2,209
Due from central banks and other institutions	9	**743**	2,244
Trading securities	10	**6,842**	5,778
Derivative financial instruments	14	**4,336**	3,805
Loans and advances to customers	11	**83,051**	79,441
Amounts due from related entities	23	**1,253**	677
Other assets	16	**557**	520
Deferred tax	15	**196**	191
Property, plant and equipment		**172**	173
Goodwill and other intangible assets		**352**	277
Total assets		**99,991**	95,315
Liabilities			
Due to central banks and other institutions	17	**1,944**	1,594
Trading liabilities		**181**	247
Derivative financial instruments	14	**3,053**	3,219
Deposits and other borrowings	18	**63,437**	59,912
Bonds and notes	19	**19,760**	20,157
Current tax liabilities		**150**	74
Amounts due to related entities	23	**913**	519
Other liabilities	20	**1,228**	828
Subordinated debt	21	**1,946**	1,824
Total liabilities		**92,612**	88,374
Net assets		**7,379**	6,941
Shareholder's equity			
Contributed equity – ordinary shares	22	**3,456**	2,351
Reserves		**38**	52
Retained profits		**3,885**	4,538
Total shareholder's equity		**7,379**	6,941
Interest earning and discount bearing assets		**92,586**	88,783
Interest and discount bearing liabilities		**82,280**	79,029

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

Cash Flow Statement

For the year ended 30 September 2018

		Consolidated	
Dollars in Millions	Note	30/9/18	30/9/17
Cash flows from operating activities			
Cash was provided from:			
Interest income		4,043	3,828
Net trading income		308	268
Other income		419	398
Cash was applied to:			
Interest expense		(2,133)	(1,987)
Personnel expenses		(543)	(492)
Other operating expenses		(334)	(337)
Taxes and subvention payments		(360)	(323)
Net cash flows from operating activities before changes in operating assets and liabilities		1,400	1,355
Changes in operating assets and liabilities arising from cash flow movements			
Net movement in due from central banks and other institutions		1,215	(950)
Net movement in loans and advances to customers		(3,718)	(5,322)
Net movement in other assets		(25)	49
Net movement in trading securities and trading liabilities		(1,125)	(905)
Net movement in deposits and other borrowings		3,526	2,417
Net movement in due to central banks and other institutions		62	187
Net movement in other liabilities		341	(50)
Net change in operating assets and liabilities		276	(4,574)
Net cash flows from operating activities		1,676	(3,219)
Cash flows from investing activities			
Cash was applied to:			
Acquisition of intangible assets		(144)	(114)
Purchase of property, plant and equipment		(57)	(53)
Net cash flows from investing activities		(201)	(167)
Cash flows from financing activities			
Net movement in bonds and notes		(1,397)	3,326
Net movement in derivative financial instruments		596	(683)
Net movement in related entity funding		302	652
Increase in contributed equity - ordinary shares	22	1,105	-
Decrease in contributed equity - perpetual preference shares	22	-	(200)
Net movement in subordinated debt	21	120	900
Ordinary dividend		(1,725)	(700)
Perpetual preference dividend		-	(3)
Net cash flows from financing activities		(999)	3,292
Net movement in cash and cash equivalents		476	(94)
Cash and cash equivalents at beginning of year		1,433	1,527
Cash and cash equivalents at end of year		1,909	1,433
Cash and cash equivalents at end of year comprised:			
Cash and liquid assets	8	2,489	2,209
Due to central banks and other institutions classified as cash and cash equivalents	17	(1,209)	(921)
Amounts due from related entities classified as cash and cash equivalents	23	1,239	561
Amounts due to related entities classified as cash and cash equivalents	23	(610)	(416)
Total cash and cash equivalents		1,909	1,433

Cash Flow Statement

For the year ended 30 September 2018

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Reconciliation of net profit attributable to shareholders of Bank of New Zealand to net cash flows from operating activities		
Net profit attributable to shareholders of Bank of New Zealand	**1,029**	937
Decrease/(increase) in accrued interest receivable	**(12)**	(15)
Depreciation and amortisation expense	**111**	96
Credit impairment charge	**82**	83
(Decrease)/increase in provision for tax	**40**	40
Unrealised gains less losses on financial instruments	**117**	150
(Decrease)/increase in accrued interest payable	**(24)**	62
(Decrease)/increase in other liabilities	**41**	5
Loss on disposal of property, plant and equipment	**16**	2
Gain on equity investments	**-**	(5)
Deduct operating cash flows not included in net profit:		
Net change in operating assets and liabilities	**276**	(4,574)
Net cash flows from operating activities	**1,676**	(3,219)

Dollars in Millions	Bonds and Notes	Subordinated Debt	Amounts due to Related Entities[1]	Amounts due from Related Entities[1]	Total
	Consolidated (30/9/18)				
Reconciliation of net debt					
Balance at beginning of year	**20,157**	**1,824**	**103**	**(116)**	**21,968**
Net cash flows	**(1,397)**	**120**	**200**	**102**	**(975)**
Non-cash changes					
Foreign exchange adjustments	**1,290**	**-**	**-**	**-**	**1,290**
Fair value adjustments	**(290)**	**-**	**-**	**-**	**(290)**
Other non-cash movements	**-**	**2**	**-**	**-**	**2**
Balance at end of year	**19,760**	**1,946**	**303**	**(14)**	**21,995**
	Consolidated (30/9/17)				
Balance at beginning of year	16,723	922	30	(695)	16,980
Net cash flows	3,326	900	73	579	4,878
Non-cash changes					
Foreign exchange adjustments	327	-	-	-	327
Fair value adjustments	(219)	-	-	-	(219)
Other non-cash movements	-	2	-	-	2
Balance at end of year	20,157	1,824	103	(116)	21,968

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

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

Note 1 Principal Accounting Policies

In these financial statements Bank of New Zealand is referred to as the "Bank". The "Banking Group" means Bank of New Zealand, all of its wholly owned entities listed in note 32 and entities consolidated for financial reporting purposes listed in note 30.

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

Basis for preparation

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

Assumptions and estimates

The preparation of the financial statements requires the use of certain critical accounting estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. It also requires management to exercise judgement in the process of applying accounting policies. The notes to the financial statements include areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Banking Group. Refer to notes 6, 12 and 24 for further information.

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

Reclassification of financial information

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

Statement of compliance

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

Changes in accounting policies and disclosures

New and amended accounting standards and interpretations

All mandatory standards, amendments and interpretations have been adopted in the current year. None had a material impact on these financial statements.

The Banking Group early adopted NZ IFRS 9 (2014) Financial Instruments from 1 October 2014. On 1 April 2018, the Banking Group ceased to apply an NZ IFRS 9 transition option that permitted the continued application of the hedge accounting requirements specified in NZ IAS 39 Financial Instruments: Recognition and Measurement. The Banking Group now applies the hedge accounting requirements of NZ IFRS 9 to hedge relationships except for fair value hedges of interest rate risk from portfolios of financial assets and financial liabilities, where NZ IAS 39 continues to apply.

The Banking Group has changed the bad and doubtful debt terminology to improve consistency with the terminology used in NZ IFRS 9. As a result of this change, the term "Impairment losses on credit exposures" has been changed to "Credit impairment charge" and the term "Provision for doubtful debts" has been changed to "Provision for credit impairment".

New and amended accounting standards and interpretations not yet effective

The following new and amended accounting standards and interpretations relevant to the Banking Group are not yet effective and have not been applied in preparing these financial statements:

- NZ IFRS 15 Revenue from Contracts with Customers introduces a single principles-based five step model for recognising revenue, and introduces the concept of recognising revenue when an obligation to a customer is satisfied. This Standard is applicable from 1 October 2018 and its impact has been assessed as immaterial.
- NZ IFRS 16 Leases significantly changes accounting for lessees, requiring recognition of all leases (subject to certain exceptions) on-balance sheet in a manner comparable to finance leases currently accounted under NZ IAS 17 Leases. Lessor accounting remains unchanged compared to NZ IAS 17. This Standard is applicable from 1 October 2019 and its potential impact is still being assessed.

Other amendments to existing standards that are not yet effective are not expected to result in a material impact on the Banking Group's reported results or financial position.

Currency of presentation

All amounts are expressed in New Zealand dollars unless otherwise stated.

Rounding of amounts

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

Principles of consolidation

NZ IFRS 10 Consolidated Financial Statements considers whether an entity has control of another entity for the purpose of consolidation where the entity is exposed, or has rights to, that other entity's (including Structured Entities) variable returns from its involvement with that entity and whether the entity has the ability to affect those returns through its power over the other entity. Entities are fully consolidated from the date on which control is transferred to the Bank. They are deconsolidated from the date that control ceases.

Note 1 Principal Accounting Policies *continued*

Principles of consolidation *continued*

In assessing whether the Banking Group controls and should consolidate a structured entity, management uses their judgement when considering the requirements of NZ IFRS 10 and NZ IFRS 12 Disclosures of Interests in Other Entities. In applying their judgement management makes assessments on whether the entity has control of another entity, taking into account factors including the following:

- the power the Banking Group has from existing rights to direct the relevant activities of the entity;
- the exposure or rights the Banking Group has to variable returns from the entity; and
- the ability of the Banking Group to affect the amount of their returns from the entity.

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

The financial results of the Bank's consolidated entities have been prepared in accordance with the Bank's accounting policies, which have been consistently applied throughout the Banking Group.

Foreign currency translation

i) Functional and presentation currency

Items included in the financial statements of each of the Banking Group's foreign operations are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The Disclosure Statement is presented in New Zealand dollars, which is the Bank's functional and presentation currency.

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow hedges. Non-monetary items are translated using the exchange rate at the date of the initial recognition of the asset or liability.

Fair value measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

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

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

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

Financial assets

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

Financial assets are classified into the following measurement categories:

- those to be measured at fair value through profit or loss; and
- those to be measured at amortised cost.

The classification depends on the Banking Group's business model for managing financial assets and the contractual terms of the financial assets' cash flows.

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

Items at fair value through profit or loss include items held for trading, items specifically designated as fair value through profit or loss on initial recognition, and debt instruments with contractual terms that do not represent solely payments of principal and interest.

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

Where a financial asset is held at fair value, the movement in fair value attributable to interest rate market movements is either an observable market value or calculated based on changes in observable market interest rates for swaps. The movement in fair value attributable to changes in credit risk is established through a statistical-based calculation to estimate expected losses attributable to adverse movements in credit risk.

Financial assets held for trading

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

Financial assets designated at fair value through profit or loss

Upon initial recognition, financial assets may be designated at fair value through profit or loss. For a financial asset, the fair value option is only applied if it eliminates an accounting mismatch that would otherwise arise from measuring items on a different basis.

Notes to and Forming Part of the Financial Statements

Note 1 Principal Accounting Policies *continued*

Financial assets *continued*

ii) Financial assets measured at amortised cost
A financial asset is measured at amortised cost only if:

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

These assets are initially recognised at fair value plus direct attributable transaction costs and subsequently measured at amortised cost.

Financial liabilities

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

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

i) Financial liabilities held at fair value through profit or loss
Items held at fair value through profit or loss comprise both items held for trading and items specifically designated at fair value through profit or loss on initial recognition. A financial liability is classified as held for trading if it is incurred principally for the purpose of selling in the near term, it forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking, or it is a derivative (not in a qualifying hedge relationship). The Banking Group has classified short sales of securities as Trading liabilities.

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

Liabilities may be designated at fair value through profit or loss if they meet the following criteria:

- where designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets and liabilities (not only financial assets and liabilities) or recognising the gains and losses on them on different bases. Where derivative financial instruments have been transacted to hedge these amounts, an accounting inconsistency would arise if such amounts were accounted for on an amortised cost basis, as the derivatives are measured at fair value with movements in fair value recognised in the income statement. By designating these amounts at fair value through profit or loss, any fair value movements on the instrument will offset the fair value movements on hedging derivatives in the income statement; or
- those that are part of a group of financial assets, financial liabilities or both, that are managed and their performance is evaluated by management on a fair value basis in accordance with the documented risk management or investment strategy; or
- those that contain one or more embedded derivatives, except if the embedded derivative does not modify significantly the associated cash flows or it is clear with little or no analysis that separation is prohibited.

Once a financial instrument has been designated at fair value through profit or loss upon initial recognition, the Banking Group cannot subsequently change the designation.

Where a financial liability is held at fair value, the movement in fair value attributable to changes in the Bank's own credit quality is calculated by determining the changes in credit spreads above observable market interest rates and recognised in other comprehensive income.

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

ii) Financial liabilities held at amortised cost
All other financial liabilities, Amounts due to related entities and certain amounts within Due to central banks and other institutions, Deposits and other borrowings and Subordinated debt are measured at amortised cost using the effective interest method.

Derecognition of financial instruments

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

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

Reserves

The asset revaluation reserve includes gross revaluation increments and any subsequent decrements arising from the revaluation of property, plant and equipment.

The cash flow hedge reserve records the effective portion of fair value revaluations of derivatives designated as cash flow hedge accounting relationships.

Income Statement Notes

Note 2 Interest

Accounting policy

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

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

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

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Interest income		
Cash and liquid assets	52	36
Due from central banks and other institutions	52	47
Trading securities	122	118
Loans and advances to customers	3,796	3,597
Individually impaired assets	4	6
Related entities	29	39
Total interest income	4,055	3,843
Total interest income was derived from financial assets:		
Not at fair value through profit or loss	3,716	3,408
At fair value through profit or loss	339	435
	4,055	3,843
Interest expense		
Due to central banks and other institutions	26	21
Deposits and other borrowings	1,403	1,270
Bonds and notes	567	646
Related entities	11	15
Subordinated debt to related entities	72	67
Subordinated notes to external investors	30	30
Total interest expense	2,109	2,049
Total interest expense was incurred on financial liabilities:		
Not at fair value through profit or loss	1,438	1,228
At fair value through profit or loss	671	821
	2,109	2,049

Note 3 Gains Less Losses on Financial Instruments

Accounting policy

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

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

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

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

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

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Trading gains less losses on financial instruments	165	149
Net gain/(loss) attributable to assets, liabilities and derivatives designated in hedge relationships	16	54
Net gain/(loss) attributable to other derivatives used for hedging purposes that no longer qualify for hedge accounting	(15)	(76)
Net gain/(loss) in the fair value of financial assets (refer to table below)	-	15
Net gain/(loss) in the fair value of financial liabilities (refer to table below)[1]	24	(20)
Other gains less losses on financial instruments	1	(4)
Total gains less losses on financial instruments	191	118
Net gain/(loss) in the fair value of financial assets include:		
Credit risk adjustments on financial assets designated at fair value through profit or loss	11	20
Gain/(loss) in the fair value of financial assets designated at fair value through profit or loss	(39)	(91)
Net gain/(loss) in the fair value of financial liabilities include:		
Gain/(loss) in the fair value of financial liabilities designated at fair value through profit or loss	196	285

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

Note 4 Other Operating Income

Accounting policy

Fees and commissions

Unless included in the effective interest calculation, fees and commissions are recognised on an accrual basis as the service is provided. Fees and commissions not integral to the effective interest rate arising from negotiating, or participating in the negotiation of a transaction with a third party, such as purchase or sale of businesses, are recognised on completion of the underlying transaction.

Funds management and other fiduciary activities

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Money transfer fees	106	111
Fees earned on financial assets and liabilities at fair value through profit or loss	41	36
Fees earned on financial assets and liabilities at amortised cost	128	122
Fees earned on trust and other fiduciary activities	15	14
Other income, other fees and commissions income	129	120
Total other operating income	419	403

Note 5 Operating Expenses

Accounting policy

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

Employee entitlements

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

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

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

Leasing

As lessee, the leases entered into by the Banking Group are primarily operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the term of the lease.

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Amortisation and depreciation		
Amortisation of intangible assets	69	53
Depreciation on property, plant and equipment	42	43
Total amortisation and depreciation	111	96
Personnel expenses		
Share based payments (refer to note 6)	7	6
Defined contribution pension expense	18	18
Salaries and other staff expenses	512	469
Total personnel expenses	537	493
Other		
Loss on disposal of property, plant and equipment	16	2
Operating lease rental expense	73	71
Related entity expenses	34	36
Other expenses[1]	274	234
Total other operating expenses	397	343
Total operating expenses[2]	1,045	932

[1] Other expenses include insurance receivable of $18 million (30 September 2017: $7 million).

[2] Total operating expenses includes a $54 million restructuring related provision raised by the Banking Group in March 2018.

	Consolidated	
Dollars in Thousands	30/9/18	30/9/17
Fees paid to auditors		
Audit and review of financial statements	1,975	1,882
Other assurance and risk related services[3]	362	389

[3] Fees paid to auditors were for other assurance services provided in relation to funding activities, due diligence, benchmark remuneration services and cyber security assessment.

Note 6 Share Based Payments Expense

Accounting policy

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

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

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

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

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

Shares and performance rights

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

The plans described below involve the provision of equity grants to employees of the Banking Group. The Banking Group reimburses National Australia Bank Limited for the cost of these grants. Details of the share based payments expense and the related entity payables are contained within notes 5 and 23 respectively.

As at 30 September 2018, share based payments expense of $18 million in relation to performance rights granted to employees of the Banking Group had not yet been charged by National Australia Bank Limited (30 September 2017: $15 million). This amount is required to be expensed in future periods under NZ IFRS 2 Share-based Payment.

a) NAB New Zealand Staff Share Allocation Plan

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

Year-end share offer

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

Under the New Zealand programme, each eligible employee is required to pay NZ$1.00 for the whole parcel of shares offered, or the market price of the parcel, whichever is less. Participating employees receive dividends and may exercise voting rights in respect of the shares, but otherwise cannot transact the shares until the restriction period concludes. If a participating employee leaves the Banking Group prior to the end of the three-year restriction period due to voluntary resignation or dismissal, the trustee will purchase the shares back for the lesser of the market price or the price paid by the employee for the shares.

b) NAB Performance Rights Plan

STI Deferral

Historically, the Banking Group's senior executives participated in the STI Deferral offer and received up to half of the value of their STI rewards in the form of National Australia Bank Limited performance rights. Employees became eligible for these rights based on their individual or business performance (or both). Deferred awards granted in respect of 2015 or earlier were granted in two equal tranches with half restricted for 12 months and the remaining half for 24 months. Deferred awards granted in respect of 2016 or 2017 were granted in either one tranche to be restricted for 12 months or two equal tranches with half restricted for 12 months and the remaining half for 24 months. Each performance right entitles the holder to subscribe for one fully paid ordinary share in National Australia Bank Limited. Performance rights lapse during the restriction period if the employee resigns or fails to pass specific compliance expectations in respect of their performance review. The National Australia Bank Limited Board may also, in its discretion, lapse all or part of an employee's performance rights.

Long term incentives

Historically, National Australia Bank Limited operated an LTI programme primarily targeted at key executive positions to help align management decisions with the long term performance of the NAB Group through the use of internal and/or external performance hurdles, generally measured over a four to five-year performance period. The programme delivered performance rights (instead of shares) aligned to National Australia Bank Limited's share price.

The performance rights plans provided for the National Australia Bank Limited Board to grant performance rights to selected senior executives of the Banking Group to subscribe for fully paid ordinary shares in National Australia Bank Limited. Each performance right entitles the holder to subscribe for one fully paid ordinary share in National Australia Bank Limited. The performance rights cannot be transferred and are not quoted on the Australian Securities Exchange. No payment is required from executives at the time of the grant. There are no voting or dividend rights attached to the performance rights. During the restriction period, all of an executive's performance rights will lapse on resignation and a pro rata portion will lapse on cessation of employment in other circumstances. Performance rights will also lapse if conduct requirements or performance hurdles are not met. The National Australia Bank Limited Board has absolute discretion to determine vesting or lapsing outcomes for the performance rights.

Note 6 Share Based Payments Expense *continued*

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

Number of Rights	Consolidated 30/9/18	30/9/17
Performance rights		
Outstanding at beginning of year	522,028	476,311
Add: Granted during the year	144,724	131,556
Add: Transferred in during the year	311,790	50,405
Deduct: Exercised during the year	89,436	37,960
Deduct: Forfeited during the year	101,435	98,284
Deduct: Transferred out during the year	297,047	-
Outstanding at end of year	490,624	522,028
Exercisable at end of year	10,849	-

The volume weighted average price of National Australia Bank Limited shares during the year ended 30 September 2018 was A$28.87 (year ended 30 September 2017: A$30.24).

Fair value of performance rights

The following table shows the significant assumptions used as inputs into the grant date fair value calculation of performance rights granted during the last two years. In the table, values have been presented as weighted averages, but the specific values for each grant are used for the fair value calculation. The table shows a 'no hurdle' value where the grant includes performance rights which have non-market based performance hurdles attached. For further details on the fair value methodology, refer to page 19.

	Consolidated 30/9/18	30/9/17
Weighted average values		
Contractual life (years)	2.9	2.6
Risk-free interest rate (per annum)	2.08%	1.81%
Expected volatility of share price	21.00%	20.00%
Closing share price on grant date	A$29.53	A$31.37
Dividend yield (per annum)	6.40%	7.40%
Fair value of performance rights	A$9.20	A$15.06
'No hurdle' value of performance rights	A$25.27	A$25.34
Expected time to vesting (years)	2.65	2.31

c) NAB Staff Share Ownership Plan

Variable Reward Plan

As announced on 19 September 2018, National Australia Bank Limited has introduced a new and simplified executive remuneration framework. For FY18, NAB Group executives will cease to receive separate awards under the STI and LTI plans and will receive one variable reward in shares. Variable reward changes for the 2018 performance year will result in a single reward being made to eligible employees, replacing the STI and Executive LTI plan (where applicable). The reward will be made in the form of ordinary shares in National Australia Bank Limited. Variable reward shares will be granted in one tranche to be restricted for four years. Shares will be forfeited during the restriction period if the employee resigns or breaches the NAB Code of Conduct during the following financial year(s) or, subject to certain exclusions, if the employee is terminated from the NAB Group. The National Australia Bank Limited Board may in its discretion, subject to compliance with the law, forfeit some or all of the variable reward or extend the deferral period if circumstances warrant.

STI Deferral

For all other executives in New Zealand, deferred equity awards granted in respect of 2018 will be granted under the NAB Staff Share Ownership Plan in one tranche of shares to be restricted for 12 months. Deferred shares are forfeited during the restriction period if the employee resigns or breaches the NAB Code of Conduct during the following financial year or, subject to certain exclusions, if the employee is terminated from the NAB Group. The National Australia Bank Limited Board may in its absolute discretion, subject to compliance with the law, forfeit some or all of the deferred shares or extend the deferral period if circumstances warrant.

Note 7 Income Tax

Accounting policy

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

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

Goods and services tax

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

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

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Income tax on operating profit charged to income statement		
Current tax	**419**	375
Deferred tax	**(19)**	(12)
Total income tax on operating profit charged to income statement	**400**	363
Reconciliation of income tax expense on operating profit shown in the income statement with prima facie tax payable on the pre-tax accounting profit		
Total operating profit before income tax expense	**1,429**	1,300
Prima facie income tax at 28%	**400**	364
Add/(deduct): Tax effect of amounts which are non-deductible or non-assessable:		
Non-assessable and tax paid income	**(1)**	(1)
Other accounting movements	**1**	-
Total income tax expense on operating profit	**400**	363
Effective tax rate	**28.0%**	27.9%
Income tax charged to other comprehensive income		
Current tax	**17**	(13)
Deferred tax	**14**	-
Total income tax charged to other comprehensive income	**31**	(13)

Imputation Credit Account

The amount of imputation credits available to the Banking Group as at 30 September 2018 was $1,475 million (30 September 2017: $1,796 million).

Asset Notes

Note 8 Cash and Liquid Assets

Accounting policy

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

Reverse repurchase agreements

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

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

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Coins, notes and cash at bank	163	138
Transaction balances with central banks	1,461	1,416
Transaction balances with other institutions	269	210
Securities purchased under agreements to resell with other institutions	596	445
Total cash and liquid assets	2,489	2,209

The Banking Group has accepted collateral with a fair value of $1,774 million as at 30 September 2018 arising from reverse repurchase agreements included in cash and liquid assets and due from related entities (refer to note 23), which it is permitted to sell or repledge (30 September 2017: $933 million).

Government securities with a fair value of $361 million were repledged as at 30 September 2018 (30 September 2017: $200 million). Securities were repledged for periods of less than three months. The Bank's obligation to repurchase government securities is classified under due to central banks and other institutions (refer to note 17).

Note 9 Due from Central Banks and Other Institutions

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Loans and advances due from other institutions	743	2,244
Total due from central banks and other institutions	743	2,244

Included in due from central banks and other institutions as at 30 September 2018 was $423 million of collateral posted with counterparties to meet standard derivative trading obligations (30 September 2017: $756 million).

Note 10 Trading Securities

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Government bonds, notes and securities	2,817	3,275
Semi-government bonds, notes and securities	2,037	843
Corporate and other institutions bonds, notes and securities	1,988	1,660
Total trading securities	6,842	5,778

Included in trading securities as at 30 September 2018 were $190 million encumbered through repurchase agreements (30 September 2017: $22 million). These trading securities have not been derecognised from the Bank as the Bank retains substantially all the risks and rewards of ownership. Counterparties have the right to sell or repledge these encumbered securities. The Bank's obligation to repurchase trading securities is classified under due to central banks and other institutions (refer to note 17) and due to related entities (refer to note 23).

Note 11 Loans and Advances to Customers

Accounting policy

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

Loans and advances are either measured at fair value through profit or loss or at amortised cost using the effective interest method, net of any provision for credit impairment. Under the effective interest method, fee income and costs directly related to the origination of the loan are deferred over the expected life of the assets or, where appropriate, a shorter period. When calculating the effective interest rate, the Banking Group estimates cash flows considering all contractual terms of the financial instrument and excluding future credit losses. Deferred and other unearned future income and expenses include interest not yet earned on the Banking Group's lease finance assets and is calculated on an amortised cost basis.

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Overdrafts	**2,562**	2,397
Credit card outstandings	**1,159**	1,135
Housing loans	**39,727**	37,358
Other term lending	**39,302**	38,290
Other lending	**787**	724
Total gross loans and advances to customers	**83,537**	79,904
Deduct:		
Provision for credit impairment and credit risk adjustments on financial assets (refer to note 12)	**603**	581
Deferred and other unearned future income and expenses	**(74)**	(77)
Fair value hedge adjustments	**(43)**	(41)
Total deductions	**486**	463
Total net loans and advances to customers	**83,051**	79,441

Included in loans and advances to customers as at 30 September 2018 was $58 million of collateral posted with counterparties to meet standard derivative trading obligations (30 September 2017: $11 million).

The BNZ RMBS Trust Series 2008-1 (the "RMBS Trust") provides an internal residential mortgage-backed securities ("RMBS") programme to issue securities as collateral for borrowing from the RBNZ. As at 30 September 2018, included within the Banking Group's loans and advances to customers were housing loans with a carrying amount of $4,471 million held by the RMBS Trust (30 September 2017: $4,471 million). These housing loans have not been derecognised by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. These housing loans and other assets (including cash) of the RMBS Trust secure debt instruments issued to the Bank as detailed in the Liquidity portfolio management section in note 34. The Banking Group had not entered into any repurchase agreements for RMBS with the RBNZ as at 30 September 2018 (30 September 2017: nil). The RBNZ had not accepted any RMBS as collateral from the Banking Group as at 30 September 2018 (30 September 2017: nil) and, as a result, the securities issued by the RMBS Trust remain unencumbered.

The BNZ Covered Bond Trust (the "Covered Bond Trust") holds certain Bank of New Zealand housing loans and its trustee guarantees the payment of all interest and principal under the covered bonds issued by the Bank and BNZ-IF. The assets of the Covered Bond Trust are not available to the Bank unless and until all prior ranking creditors of the Covered Bond Trust have been satisfied. As at 30 September 2018, included within the Banking Group's loans and advances to customers were housing loans with a carrying amount of $5,051 million held by the Covered Bond Trust (30 September 2017: $6,045 million). These housing loans have not been derecognised by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. The Banking Group had issued debt securities with a face value of $4,565 million that were guaranteed by the Covered Bond Trust as at 30 September 2018 (30 September 2017: $5,032 million). The underlying collateral that supports the guarantee provided by the Covered Bond Trust comprised housing loans and other assets (including cash) with a carrying amount of $5,088 million as at 30 September 2018 (30 September 2017: $6,089 million).

Further details on the transactions with the RMBS Trust and the Covered Bond Trust are provided in notes 19, 26, 30 and 34.

Note 12 Provision for Credit Impairment

Accounting policy

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

- debt instruments measured at amortised cost; and
- loan commitments.

Assets migrate through the following three stages based on their change in credit quality since initial recognition:

i) Stage 1: 12-months ECL
For exposures where there has not been a significant increase in credit risk since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

ii) Stage 2: Lifetime ECL–not credit impaired
For exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL (i.e. reflecting the remaining lifetime of the financial asset) is recognised.

iii) Stage 3: Lifetime ECL–credit impaired
Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.

At each reporting date, the Banking Group assesses whether there has been a significant increase in credit risk since initial recognition by comparing the risk of default occurring over the expected life between that of the reporting date to that of the date of initial recognition. In determining whether credit risk has increased significantly since initial recognition, the Banking Group uses its internal credit risk grading system, external risk ratings and forecast information to assess deterioration in credit quality of a financial asset.

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

The amount of ECL is measured as the probability-weighted present value of all cash shortfalls over the expected life of the financial asset discounted at its original effective interest rate. The cash shortfall is the difference between all contractual cash flows that are due to the Banking Group and all the cash flows that the Banking Group expects to receive. The amount of the loss is recognised as a provision for credit impairment.

The Banking Group considers its historical loss experience and adjusts this for current observable data. In addition, the Banking Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rates, gross domestic product, inflation and commercial property prices, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect ECL.

If, in a subsequent reporting period, the credit quality improves and reverses any previously assessed significant increase in credit risk since origination, then the provision for credit impairment reverts from lifetime ECL to 12-months ECL.

Judgement is required by management in the estimation of the amount and timing of future cash flows when determining an impairment loss for loans and advances. In estimating these cash flows, the Banking Group makes judgements about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

A collective assessment of impairment takes into account data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.) and concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups).

	Consolidated (30/9/18)			
Dollars in Millions	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	Total
Loans and advances to customers				
Collective provision for credit impairment measured on a 12-months ECL	1	14	51	66
Provision for credit impairment measured on a lifetime ECL				
Collective provision lifetime ECL not credit impaired	50	13	303	366
Collective provision lifetime ECL credit impaired	4	12	35	51
Specific provision lifetime ECL credit impaired	3	5	95	103
Total provision for credit impairment measured on a lifetime ECL	57	30	433	520
Total provision for credit impairment	58	44	484	586
	Consolidated (30/9/17)			
Loans and advances to customers				
Collective provision for credit impairment measured on a 12-months ECL	2	15	52	69
Provision for credit impairment measured on a lifetime ECL				
Collective provision lifetime ECL not credit impaired	51	12	246	309
Collective provision lifetime ECL credit impaired	6	10	57	73
Specific provision lifetime ECL credit impaired	7	6	89	102
Total provision for credit impairment measured on a lifetime ECL	64	28	392	484
Total provision for credit impairment	66	43	444	553

Note 12 Provision for Credit Impairment *continued*

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

	Consolidated				
Dollars in Millions	Collective Provision 12-months ECL 30/9/18	Collective Provision Lifetime ECL Not Credit Impaired 30/9/18	Collective Provision Lifetime ECL Credit Impaired 30/9/18	Specific Provision Lifetime ECL Credit Impaired 30/9/18	Total 30/9/18
Movement in provision for credit impairment					
Residential mortgage lending					
Balance at beginning of year	2	51	6	7	66
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	3	(2)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	-	1	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(1)	1	-	-
Transferred to specific provision lifetime ECL credit impaired	-	-	(1)	1	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(4)	1	-	(1)	(4)
Amounts written off	-	-	-	(4)	(4)
Recovery of amounts written off	-	-	-	-	-
Balance at end of year - Residential mortgage lending	1	50	4	3	58
Other retail exposures					
Balance at beginning of year	15	12	10	6	43
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	5	(4)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(1)	2	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(2)	2	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(2)	(5)	7	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(5)	7	7	20	29
Amounts written off	-	-	-	(40)	(40)
Recovery of amounts written off	-	-	-	12	12
Balance at end of year - Other retail exposures	14	13	12	5	44
Corporate exposures					
Balance at beginning of year	52	246	57	89	444
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	63	(61)	(2)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(12)	34	(22)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(4)	4	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(2)	(11)	13	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(52)	90	9	10	57
Amounts written off	-	-	-	(24)	(24)
Recovery of amounts written off	-	-	-	11	11
Discount unwind [2]	-	-	-	(4)	(4)
Balance at end of year - Corporate exposures	51	303	35	95	484
Total					
Balance at beginning of year	69	309	73	102	553
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	71	(67)	(4)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(13)	37	(24)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(7)	7	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(4)	(17)	21	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(61)	98	16	29	82
Amounts written off	-	-	-	(68)	(68)
Recovery of amounts written off	-	-	-	23	23
Discount unwind [2]	-	-	-	(4)	(4)
Total provision for credit impairment balance at end of year	66	366	51	103	586

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

Note 12 Provision for Credit Impairment *continued*

Dollars in Millions	Consolidated Collective Provision 12-months ECL 30/9/17	Collective Provision Lifetime ECL Not Credit Impaired 30/9/17	Collective Provision Lifetime ECL Credit Impaired 30/9/17	Specific Provision Lifetime ECL Credit Impaired 30/9/17	Total 30/9/17
Movement in provision for credit impairment					
Residential mortgage lending					
Balance at beginning of year	1	12	4	11	28
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	2	(1)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	-	-	-	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(1)	1	-	-
Transferred to specific provision lifetime ECL credit impaired	-	-	(1)	1	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(1)	41	3	(1)	42
Amounts written off	-	-	-	(4)	(4)
Recovery of amounts written off	-	-	-	-	-
Balance at end of year - Residential mortgage lending	2	51	6	7	66
Other retail exposures					
Balance at beginning of year	13	10	8	8	39
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	4	(3)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(1)	2	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(1)	1	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(1)	(4)	5	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(1)	5	7	16	27
Amounts written off	-	-	-	(34)	(34)
Recovery of amounts written off	-	-	-	11	11
Balance at end of year - Other retail exposures	15	12	10	6	43
Corporate exposures					
Balance at beginning of year	46	213	91	80	430
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	51	(51)	-	-	-
Transferred to collective provision lifetime ECL not credit impaired	(8)	37	(29)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(5)	5	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(2)	(6)	8	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(37)	54	(4)	1	14
Amounts written off	-	-	-	(11)	(11)
Recovery of amounts written off	-	-	-	13	13
Discount unwind [2]	-	-	-	(2)	(2)
Balance at end of year - Corporate exposures	52	246	57	89	444
Total					
Balance at beginning of year	60	235	103	99	497
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	57	(55)	(2)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(9)	39	(30)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(7)	7	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(3)	(11)	14	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) [1]	(39)	100	6	16	83
Amounts written off	-	-	-	(49)	(49)
Recovery of amounts written off	-	-	-	24	24
Discount unwind [2]	-	-	-	(2)	(2)
Total provision for credit impairment balance at end of year	69	309	73	102	553

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

Note 12 Provision for Credit Impairment *continued*

Impact of changes in gross carrying amount on ECL

The following explains how significant changes in the gross carrying amount of financial assets during the year have contributed to the changes in the provision for credit impairment. Provision for credit impairment reflects ECL measured using the three-stage approach under NZ IFRS 9.

Overall, the net increase in the total provision for credit impairment of $33 million was mainly driven by increases in collective provisioning and specific provisioning for credit impaired assets, partially offset by write-offs during the year. The increase was mainly attributed to an increase in the corporate segment of $40 million. This was partially offset by an $8 million decrease in the provisioning level for the residential mortgage lending segment.

- Collective provision 12-months ECL (Stage 1) decreased by $3 million in spite of a $2 billion increase in loans and advances. This was mainly due to the better credit quality of the $23 billion of loans and advances that were newly originated and transferred from Stage 2 or Stage 3 due to credit improvement than the $21 billion of loans and advances that were repaid, experienced movements in underlying account balances during the period and transferred to Stage 2 or Stage 3 due to deterioration in credit quality.
- Collective provision lifetime ECL not credit impaired (Stage 2) increased by $57 million, mainly due to $11 billion of loans and advances that were newly originated and transferred from Stage 1 or Stage 3 and forward looking adjustments established in the corporate segment reflecting management's outlook of the emerging level of credit risk in this segment. This was partially offset by $8 billion of loans and advances that were repaid and transferred to Stage 1 or Stage 3.
- Collective provision lifetime ECL credit impaired (Stage 3) decreased by $22 million, mainly due to $524 million of loans and advances that were repaid and transferred to Stage 1 or Stage 2 due to improvement in credit quality. This was partially offset by $254 million of loans and advances that were transferred from Stage 1 or Stage 2 due to deterioration in credit quality.
- Specific provision lifetime ECL credit impaired (Stage 3) increased by $1 million due to $26 million increase in individually impaired loans and advances. The increase was mainly due to $267 million of loans and advances that experienced change in the underlying account balances or were transferred from previously being assessed collectively. This was partially offset by $241 million loans and advances that were repaid or written off during the period.

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

As at 30 September 2018, the contractual amount outstanding on loans and advances to customers written off during the year, and that are still subject to enforcement activity was $9 million for the Banking Group (30 September 2017: $9 million).

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

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

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

	Consolidated (30/9/18)			
Dollars in Millions	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	Total
Credit risk adjustment on individual financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	2	2
Charge/(credit) to income statement	-	-	-	-
Amounts written off	-	-	-	-
Balance at end of year	-	-	2	2
Credit risk adjustment on groups of financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	26	26
Charge/(credit) to income statement	-	-	(11)	(11)
Balance at end of year	-	-	15	15
Total credit risk adjustments on loans and advances designated at fair value through profit or loss	-	-	17	17
Trading derivative financial instruments				
Balance at beginning of year	-	-	14	14
Charge/(credit) to income statement	-	-	(3)	(3)
Balance at end of year	-	-	11	11
Total credit risk adjustments on trading derivative financial instruments	-	-	11	11

Note 12 Provision for Credit Impairment *continued*

Dollars in Millions	Consolidated (30/9/17) Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	Total
Credit risk adjustment on individual financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	1	1
Charge/(credit) to income statement	-	-	1	1
Amounts written off	-	-	-	-
Balance at end of year	-	-	2	2
Credit risk adjustment on groups of financial assets				
Loans and advances to customers				
Balance at beginning of year	-	1	46	47
Charge/(credit) to income statement	-	(1)	(20)	(21)
Balance at end of year	-	-	26	26
Total credit risk adjustments on loans and advances designated at fair value through profit or loss	-	-	28	28
Trading derivative financial instruments				
Balance at beginning of year	-	-	12	12
Charge/(credit) to income statement	-	-	2	2
Balance at end of year	-	-	14	14
Total credit risk adjustments on trading derivative financial instruments	-	-	14	14

Note 13 Asset Quality

Accounting policy

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

- **Impaired assets** means any credit exposure for which an impairment loss is required in accordance with NZ IFRS 9.

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

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

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

Note 13 Asset Quality *continued*

Dollars in Millions	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	Total
	Consolidated (30/9/18)			
Movements in pre-allowance balances				
Individually impaired assets - at amortised cost				
Balance at beginning of year	19	10	193	222
Amounts written off	(4)	(40)	(24)	(68)
Additions	26	48	193	267
Deletions	(28)	(10)	(135)	(173)
Balance at end of year	13	8	227	248
Specific provision for credit impairment	3	5	95	103
Individually impaired assets - at fair value through profit or loss				
Balance at beginning of year	-	-	28	28
Amounts written off	-	-	-	-
Additions	-	-	4	4
Deletions	-	-	(15)	(15)
Balance at end of year	-	-	17	17
Credit risk adjustments on individual financial assets designated at fair value through profit or loss	-	-	2	2
Total impaired assets at end of year [1]	13	8	244	265
Individually impaired assets - undrawn lending commitments				
At amortised cost	-	-	3	3
At fair value through profit or loss	-	-	-	-
Other assets under administration	5	2	-	7
	Consolidated (30/9/17)			
Movements in pre-allowance balances				
Individually impaired assets - at amortised cost				
Balance at beginning of year	31	14	201	246
Amounts written off	(4)	(34)	(11)	(49)
Additions	26	41	175	242
Deletions	(34)	(11)	(172)	(217)
Balance at end of year	19	10	193	222
Specific provision for credit impairment	7	6	89	102
Individually impaired assets - at fair value through profit or loss				
Balance at beginning of year	-	-	7	7
Amounts written off	-	-	-	-
Additions	-	-	26	26
Deletions	-	-	(5)	(5)
Balance at end of year	-	-	28	28
Credit risk adjustments on individual financial assets designated at fair value through profit or loss	-	-	2	2
Total impaired assets at end of year	19	10	221	250
Individually impaired assets - undrawn lending commitments				
At amortised cost	-	-	4	4
At fair value through profit or loss	-	-	-	-
Other assets under administration	10	1	2	13

Note 13 Asset Quality *continued*

Dollars in Millions	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	Total
	Consolidated (30/9/18)			
Past due assets not impaired				
Loans and advances to customers				
1 - 7 days past due	144	67	233	444
8 - 29 days past due	74	33	46	153
1 - 29 days past due	218	100	279	597
30 - 59 days past due	46	14	37	97
60 - 89 days past due	23	8	20	51
90+ days past due	20	15	78	113
Total past due assets not impaired	307	137	414	858
	Consolidated (30/9/17)			
Past due assets not impaired				
Loans and advances to customers				
1 - 7 days past due	101	62	232	395
8 - 29 days past due	75	37	18	130
1 - 29 days past due	176	99	250	525
30 - 59 days past due	50	13	42	105
60 - 89 days past due	18	7	9	34
90+ days past due	32	15	103	150
Total past due assets not impaired	276	134	404	814

Note 14 Derivative Financial Instruments

Accounting Policy

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

The method of recognising the fair value gain or loss on a derivative depends on whether the derivative is used as a hedging instrument and, if so, the nature of the item being hedged. The Banking Group designates certain derivatives entered into for risk management purposes as either hedges of the fair value of recognised assets and liabilities or firm commitments (fair value hedge) or hedges of highly probable future cash flows attributable to a recognised asset or liability or a forecast transaction (cash flow hedge). Hedge accounting is generally used for derivatives designated in this way, provided certain criteria are met. Derivatives used for risk management purposes which, for various reasons, do not meet the qualifying criteria for hedge accounting, are included in derivatives held or issued for trading purposes.

The Banking Group elected to apply NZ IFRS 9 to account for designated hedge relationships, other than portfolio fair value hedges, from 1 April 2018. As part of the requirements to apply hedge accounting, the Banking Group at the inception of the transaction, documents the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Banking Group also documents how effectiveness will be measured throughout the life of the hedge relationship and its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items. The Banking Group measures hedge effectiveness on a prospective basis at inception, as well as retrospectively over the term of the hedge relationship. The Banking Group continues to account for designated portfolio fair value hedge relationships under NZ IAS 39 as dynamic portfolio risk management is out of scope under NZ IFRS 9.

Any derivative that is de-designated as a hedging derivative will be accounted for as trading from the time that it is de-designated, with all subsequent movements in fair value recognised in the income statement.

Derivative financial instruments held or issued for trading purposes

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

	Consolidated (30/9/18)			Consolidated (30/9/17)		
Dollars in Millions	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**	Notional Principal	Fair Value Assets	Fair Value Liabilities
Held for trading - at fair value [1]						
Foreign exchange rate related contracts						
Spot and forward contracts to purchase foreign exchange	**86,314**	**838**	**716**	48,882	399	461
Cross currency swaps	**56,865**	**983**	**675**	52,618	753	903
Options	**4,690**	**47**	**47**	5,277	62	62
	147,869	**1,868**	**1,438**	106,777	1,214	1,426
Interest rate related contracts						
Forward rate agreements	**762**	**-**	**-**	60	-	-
Swaps	**749,045**	**2,382**	**1,579**	622,794	2,533	1,776
Futures[2]	**190,818**	**-**	**-**	389,069	-	-
Options	**122**	**-**	**-**	181	-	-
	940,747	**2,382**	**1,579**	1,012,104	2,533	1,776
Other market related contracts						
Commodity derivatives	**203**	**31**	**31**	275	10	10
Credit derivatives	**496**	**5**	**5**	459	5	5
	699	**36**	**36**	734	15	15
Total held for trading – at fair value	**1,089,315**	**4,286**	**3,053**	1,119,615	3,762	3,217
Held for hedging – fair value hedges[3]						
Interest rate related contracts						
Swaps	**12,868**	**-**	**-**	15,234	-	1
Total held for hedging – fair value hedges	**12,868**	**-**	**-**	15,234	-	1
Held for hedging – cash flow hedges						
Interest rate related contracts						
Futures[2]	**8,949**	**-**	**-**	13,640	-	-
Swaps	**12,593**	**50**	**-**	10,909	43	1
Total held for hedging – cash flow hedges	**21,542**	**50**	**-**	24,549	43	1
Total derivative contracts	**1,123,725**	**4,336**	**3,053**	1,159,398	3,805	3,219

[1] Held for trading derivative financial instruments include some derivatives that are used for hedging purposes that are not in designated hedge accounting relationships.

[2] The calculation of the notional amount reflects the gross volume of transactions outstanding at the reporting period end and is not indicative of either the market risk or credit risk.

[3] Fair value hedges that are held for hedging but ineffective at balance date are included in the Held for trading - at fair value category.

Note 14 Derivative Financial Instruments *continued*

Derivative financial instruments held or issued for purposes other than trading

The Banking Group applies fair value hedge accounting to hedge movements in the value of fixed interest rate assets and liabilities subject to interest rate risk. The Banking Group applies cash flow hedge accounting to hedge the variability in highly probable forecast future cash flows attributable to interest rate risk on variable rate assets and liabilities.

Fair value hedges

Derivatives are held for the purpose of managing existing and anticipated interest rate risk, in particular to swap the exposure from fixed rate assets and liabilities to a floating interest rate. The Banking Group hedges its exposure to changes in the fair value of fixed rate assets and liabilities in respect of the benchmark interest rate.

In addition, derivatives are entered into to manage interest rate risk from a portfolio of exposures, namely amounts due from fixed rate housing loans. A dynamic process is used for these portfolio fair value hedges as the make-up of the portfolio of fixed rate housing loans changes with early repayments, new originations and maturities. The hedge relationship is frequently discontinued, reset and re-designated generally on a weekly basis. The tables in this note include these portfolio hedging relationships because the volume of fixed rate housing loans hedged is relatively stable, and it is the change in the make-up of the portfolio and desire to maximise the hedge effectiveness result that drive the dynamic hedging strategy.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify for fair value hedge accounting are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item is amortised to the income statement on an effective yield basis over the remaining period to maturity of the hedged item. Where the hedged item is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the income statement.

Regression analysis and cumulative dollar offset method are used to test hedge effectiveness and establish the hedge ratio. The cumulative dollar offset method is also used for retrospective hedge effectiveness testing. All fair value hedges have an element of hedge ineffectiveness due to the valuation of the floating leg of interest rate swaps where coupons are reset at the beginning of the coupon period and the discount rate used to discount the coupon cash flows are based on the rate at the end of the coupon period.

The profile of the timing of the notional amount of derivatives designated in fair value hedge relationships is outlined in the following tables.

			Consolidated (30/9/18)		
Dollars in Millions	**3 Months or less**	**3 to 12 Months**	**1 to 5 Years**	**Over 5 Years**	**Total**
Interest rate swaps					
Pay fixed	**1,250**	**4,455**	**7,143**	**20**	**12,868**
Receive fixed	**-**	**-**	**-**	**-**	**-**
Total notional amount	**1,250**	**4,455**	**7,143**	**20**	**12,868**
			Consolidated (30/9/17)		
Interest rate swaps					
Pay fixed	1,723	4,306	8,528	35	14,592
Receive fixed	75	567	-	-	642
Total notional amount	1,798	4,873	8,528	35	15,234

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

		Consolidated		
Dollars in Millions	**Carrying Amount 30/9/18**	Carrying Amount 30/9/17	**Fair value hedge adjustments 30/9/18**	Fair value hedge adjustments 30/9/17
Loans and advances (housing loans)[1]	**12,868**	13,950	**43**	41

[1] The carrying amount of housing loans in a portfolio fair value hedge relationship is approximate and represents the principal of the loans.

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Gains/(losses) on hedging instruments	**12**	158
Gains/(losses) on hedged items attributable to the hedged risk	**3**	(104)
Hedge ineffectiveness recognised in the income statement[2]	**15**	54

[2] Hedge ineffectiveness was recognised in gains less losses on financial instruments at fair value in the income statement.

Note 14 Derivative Financial Instruments *continued*

Cash flow hedges

The operations of the Banking Group are subject to the risk of interest rate fluctuations to the extent of the repricing profile of the Banking Group's balance sheet. Derivatives are held for the purpose of managing existing or anticipated interest rate risk. Derivatives are entered into after consideration of the interest rate risk from a portfolio of exposures, such as a portfolio of assets, or the net exposure from a portfolio of assets and liabilities. Where derivatives are used, they are designated in a cash flow hedge relationship where possible to manage the profit and loss volatility associated with the derivatives which would otherwise be measured at fair value through profit or loss. This requires identification of eligible assets or liabilities, and designation of derivatives to obtain hedge accounting. Cash flow hedge accounting involves designating derivatives as hedges of the variability in highly probable forecast future cash flows attributable to interest rate risk from the benchmark interest rate on variable rate assets and liabilities.

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 the ineffective portion is recognised immediately in the income statement. Amounts accumulated in reserves are transferred to the income statement in the period in which the hedged item will affect profit or loss. As the Banking Group's cash flow hedges are in respect of interest rate risk, transfers to the income statement are recognised in net interest income.

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

Methods used to test hedge effectiveness and establish the hedge ratio include regression analysis, and in some cases for portfolio hedge relationships where interest rate risk is managed centrally, comparison to ensure the expected interest cash flows exceed the hedged interest cash flows.

There were no transactions for which cash flow hedge accounting had to be ceased during the year ended 30 September 2018 as a result of the highly probable cash flows no longer being expected to occur (year ended 30 September 2017: nil).

The profile of the timing of the notional amount of derivatives designated in cash flow hedge relationships is outlined in the following tables.

	Consolidated (30/9/18)				
Dollars in Millions	3 Months or less	3 to 12 Months	1 to 5 Years	Over 5 Years	Total
Interest rate swaps					
Pay fixed	**600**	**1,134**	**3,176**	**66**	**4,976**
Receive fixed	**395**	**1,397**	**5,790**	**35**	**7,617**
Other interest rate derivatives[1]					
Pay fixed	**2,200**	**2,050**	**-**	**-**	**4,250**
Receive fixed	**2,400**	**2,299**	**-**	**-**	**4,699**
Total notional amount	**5,595**	**6,880**	**8,966**	**101**	**21,542**
	Consolidated (30/9/17)				
Interest rate swaps					
Pay fixed	231	552	4,002	106	4,891
Receive fixed	239	928	4,796	55	6,018
Other interest rate derivatives[1]					
Pay fixed	3,655	2,190	150	-	5,995
Receive fixed	3,855	3,640	150	-	7,645
Total notional amount	7,980	7,310	9,098	161	24,549

[1] Other interest rate derivatives include interest rate futures.

Cash flow hedge relationships gave rise to the following movements in the cash flow hedge reserve.

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Balance at beginning of year	**49**	113
Transferred to interest income in the income statement	**(363)**	(328)
Transferred to interest expense in the income statement	**321**	286
Net gains from change in fair value	**42**	(22)
Net movement before tax	**-**	(64)
Deferred tax	**(14)**	-
Balance at end of year	**35**	49

A gain of $1 million was recognised in gains less losses on financial instruments at fair value in the income statement related to hedge ineffectiveness from cash flow hedge relationships for the year ended 30 September 2018 (year ended 30 September 2017: nil).

There is no balance remaining in the cash flow hedge reserve from any hedging relationship for which hedge accounting is no longer applied.

Credit risk

The maximum exposure to credit risk at any one time is limited to the current fair value of instruments that are favourable to the Banking Group (assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. For information on the Banking Group's risk management policies, refer to note 34.

Note 15 Deferred Tax

Accounting policy

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

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

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

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

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

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

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Deferred tax assets		
Balance at beginning of year	**191**	179
Tax expense recognised in income statement	**19**	12
Tax credit recognised in other comprehensive income/(expense)	**(14)**	-
Balance at end of year	**196**	191
Deferred tax assets were attributable to the following items:		
Employee entitlements	**15**	15
Credit risk adjustments on financial assets designated at fair value through profit or loss	**10**	12
Provision for credit impairment on credit exposures	**169**	159
Depreciation and amortisation	**(6)**	(5)
Operating expense provisions	**22**	11
Prepaid pension assets	**(2)**	(1)
Cash flow hedge reserve	**(14)**	-
Other	**2**	-
Total deferred tax assets	**196**	191

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

Note 16 Other Assets

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Accrued interest receivable	**154**	142
Prepaid pension assets	**5**	5
Securities sold – not yet settled	**166**	121
Other assets[1]	**232**	252
Total other assets	**557**	520

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

Notes to and Forming Part of the Financial Statements

Liability Notes

Note 17 Due to Central Banks and Other Institutions

Accounting policy

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

Repurchase agreements

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Transaction balances with other institutions[1]	896	798
Deposits from central banks	204	103
Deposits from other institutions[2]	549	587
Securities sold under agreements to repurchase from other institutions[1]	295	106
Total due to central banks and other institutions	1,944	1,594

[1] Classified as cash and cash equivalents in the cash flow statement.
[2] Included in deposits from other institutions as at 30 September 2018 was $18 million classified as cash and cash equivalents in the cash flow statement (30 September 2017: $17 million).

Included in due to central banks and other institutions as at 30 September 2018 was $480 million of collateral posted by counterparties to meet standard derivative trading obligations (30 September 2017: $457 million).

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

Note 18 Deposits and Other Borrowings

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Deposits not bearing interest	5,781	5,087
On-demand and short term deposits bearing interest	20,139	18,850
Term deposits	33,856	32,194
Total customer deposits	59,776	56,131
Certificates of deposit	1,794	1,351
Commercial paper	1,867	2,430
Total deposits and other borrowings	63,437	59,912

Included in deposits and other borrowings as at 30 September 2018 was $2 million of collateral posted by counterparties to meet standard derivative trading obligations (30 September 2017: $1 million).

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

Notes to and Forming Part of the Financial Statements

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Note 19 Bonds and Notes		
Domestic Covered Bonds	**617**	971
Offshore Covered Bonds	**3,953**	4,129
Domestic medium term notes	**3,162**	3,555
Offshore medium term notes	**12,028**	11,502
Total bonds and notes	**19,760**	20,157

As at 30 September 2018, the contractual amount to be paid at maturity of the Bonds and notes is $19,768 million (30 September 2017: $19,875 million).

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Bonds and notes by currency type:		
US Dollar	**7,571**	7,212
New Zealand Dollar	**3,832**	4,581
British Pound	**585**	550
Australian Dollar	**34**	34
Hong Kong Dollar	**338**	305
Euro	**5,928**	5,894
Japanese Yen	**253**	260
Swiss Franc	**1,219**	1,321
Total bonds and notes by currency type	**19,760**	20,157

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Note 20 Other Liabilities		
Accrued interest payable	**364**	346
Payables and accrued expenses	**162**	124
Securities purchased – not yet settled	**421**	134
Employee entitlements	**110**	116
Other liabilities[1]	**171**	108
Total other liabilities	**1,228**	828

[1] Other liabilities includes payables relating to settlements clearing and a restructuring-related provision.

As at 30 September 2018, $170 million (30 September 2017: $144 million) of certain unsecured liabilities as set out in Schedule 7 of the Companies Act 1993 rank in priority to general creditors' claims in a winding up of the Bank.

Dollars in Millions	Consolidated 30/9/18	30/9/17
Note 21 Subordinated Debt		
Subordinated loans due to related entities		
NAB Capital LLC	-	150
National Equities Limited	-	230
Total subordinated loans due to related entities	-	380
Subordinated notes due to related entity		
National Australia Bank Limited	500	-
Total subordinated notes due to related entity	500	-
Perpetual notes due to related entity		
National Australia Bank Limited	900	900
Total perpetual notes due to related entity	900	900
Subordinated notes due to external investors		
Subordinated notes due to external investors	546	544
Total subordinated notes due to external investors	546	544
Total subordinated debt	1,946	1,824

Subordinated Loans due to related entities
Subordinated loans due to related entities of $230 million and $150 million were repaid on 15 March 2018 and 8 May 2018 respectively.

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

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

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

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

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

Under the terms and conditions of the Subordinated Notes, an NVTE will occur if: (i) the RBNZ gives the Bank a direction under the Reserve Bank of New Zealand Act 1989 ("RBNZ Act") requiring the Bank to exercise its right of conversion or write off of its Tier Two capital instruments; (ii) the Bank is made subject to statutory management under the RBNZ Act and the New Zealand statutory manager announces his or her decision to convert or write off the Bank's Tier Two capital instruments.

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

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

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

Note 21 Subordinated Debt *continued*

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

Conversion

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

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

On the Optional Exchange Date, or on any date if a regulatory or tax event occurs, the Bank may, subject to certain conditions, convert or repay some or all of the Perpetual Notes.

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

Ranking of Perpetual Notes

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

Subordinated Notes due to external investors treated as Tier Two capital

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

Redemption

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

Interest

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

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

Conversion

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

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

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

Ranking of Listed Subordinated Notes

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

Shareholders' Equity Notes

Number of shares in Millions	Consolidated 30/9/18	30/9/17
Note 22 Contributed Equity		
Issued and paid-up shares		
Ordinary shares, fully paid – balance at beginning of year	**3,371**	3,371
Ordinary shares issued during the year	**1,105**	-
Ordinary shares, fully paid – balance at end of year	**4,476**	3,371
Perpetual preference shares, fully paid – balance at beginning of year	**-**	200
Buyback of shares	**-**	(200)
Total issued and paid-up shares	**4,476**	3,371

The issued and paid-up capital is included in Tier One capital of the Banking Group and the Registered Bank (refer to note 33).

Ordinary shares

The authorised ordinary share capital of the Bank comprises 4,475,997,499 shares with a balance of $3,456 million (30 September 2017: 3,370,997,499 shares; $2,351 million), which do not have a par value. All issued shares were fully paid as at the reporting date. Each of the 4,475,997,499 ordinary shares entitles the shareholder to one vote at any meeting of shareholders.

Dividends on ordinary shares for the year ended 30 September 2018 were a weighted average of 40.43 cents per share (year ended 30 September 2017: 20.77 cents per share).

On 8 December 2017, the Board of the Bank resolved that the Bank pay dividends of $1.405 billion on its ordinary shares. Effected on the same date, the Board of the Bank also approved the issuance of 1.105 billion ordinary shares to NAGNZ at a subscription price of $1.00 per share. This resulted in a net payment to NAGNZ of $300 million.

Refer to note 35 for further information.

Perpetual non-cumulative preference shares

On 28 December 2016, the Bank bought back the $200 million of perpetual non-cumulative preference shares ("2009A BNZ PPS") issued to National Australia Group (NZ) Limited on 29 December 2009.

Dividends on the 2009A BNZ PPS for the year ended 30 September 2017 were 1.67 cents per share.

Other Notes

Note 23 Related Entity Transactions

The Bank is a wholly owned controlled entity of NAGNZ. The ultimate parent bank of Bank of New Zealand is National Australia Bank Limited. During the year ended 30 September 2018, there were dealings between the Bank and its related entities (including NAB) as well as other related parties (including key management personnel, their close family members and their controlled entities). Details of these transactions are outlined on pages 40 to 41.

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

Related entities

Total balances with related entities

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Amounts due from ultimate parent	1,222	640
Amounts due from controlled entities of ultimate parent	31	37
Total amounts due from related entities [1]	1,253	677
Derivative financial assets with related entities	1,496	1,294
Amounts due to ultimate parent	544	216
Amounts due to controlled entities of ultimate parent	369	303
Total amounts due to related entities [2]	913	519
Derivative financial liabilities with related entities	1,210	1,393
Subordinated debt due to related entities (refer to note 21)	1,400	1,280

[1] Included in amounts due from related entities as at 30 September 2018 was $1,239 million classified as cash and cash equivalent in the cash flow statement (30 September 2017: $561 million).
[2] Included in amounts due to related entities as at 30 September 2018 was $610 million classified as cash and cash equivalent in the cash flow statement (30 September 2017: $416 million).

No provisions have been recognised in respect of loans provided to related entities (year ended 30 September 2017: nil). There were no debts with any of the above parties written off or forgiven during the year ended 30 September 2018 (year ended 30 September 2017: nil).

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

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
Amounts due from related entities		
Collateral loan posted to ultimate parent to meet standard derivative trading obligations	-	101
Securities purchased under agreements to resell to ultimate parent	1,199	514
Amounts due to related entities		
Intercompany payable in respect of share based payments included in amounts due to ultimate parent	7	6
Collateral deposit posted by ultimate parent to meet standard derivative trading obligations	206	-
Securities sold under agreements to repurchase from ultimate parent	255	116

Transactions with related entities

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

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

Dividends paid to the shareholders are disclosed in the Statement of Changes in Equity and in note 22.

For the year ended 30 September 2018, $10 million of imputation credits from the group imputation credit account (year ended 30 September 2017: $10 million) were attached to dividends paid by National Wealth Management New Zealand Holdings Limited, a controlled entity of the Bank's ultimate parent.

BNZ Investment Services Limited ("BNZISL"), a wholly owned controlled entity of the Bank, is the manager and issuer of the BNZ KiwiSaver Scheme ("KiwiSaver"), the Private Wealth Series ("PWS"), the YouWealth Scheme, the BNZ Cash PIE and the BNZ Term PIE (collectively the "Investment Schemes"). The banking arrangements for these Investment Schemes are provided by the Bank. Investments by the Investment Schemes currently include, among other things, bank deposits with the Bank. As at 30 September 2018, KiwiSaver held $16 million in the transactional bank accounts (30 September 2017: $11 million) and PWS held $7 million in the transactional bank accounts (30 September 2017: $21 million). Refer to note 30 for further information.

The RMBS Trust provides an internal residential mortgage-backed securities programme to issue securities as collateral for borrowing from the RBNZ. The Covered Bond Trust holds certain Bank of New Zealand housing loans and its trustee guarantees covered bonds issued by the Bank and BNZ-IF. Refer to note 11 for further information.

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

Note 23 Related Entity Transactions *continued*

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Interest income on amounts due from related entities		
Ultimate parent	29	34
Controlled entities of ultimate parent	-	5
Total interest income on amounts due from related entities	29	39
Interest expense on amounts due to related entities		
Ultimate parent	73	66
Controlled entities of ultimate parent	10	16
Total interest expense on amounts due to related entities	83	82
Other operating income		
Net unrealised gain/(loss) on derivative contracts with ultimate parent	385	389
Commissions received from controlled entities of ultimate parent for sale of insurance	22	22
Net gain/(loss) attributable to financial liabilities at amortised cost	-	(5)
Operating expenses		
Intercompany recharges paid to ultimate parent	29	31
Other service charges paid to ultimate parent	5	5
Other transactions		
Payment/(reimbursement) for the use of tax losses to controlled entities of ultimate parent	10	(9)

Key management personnel

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

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

- on normal terms and conditions; or
- on terms and conditions which apply to other employees in the Bank.

All loans made to key management personnel have been made in accordance with the Bank's lending policies. No provisions have been recognised in respect of loans provided to key management personnel. There were no debts written off or forgiven during the year ended 30 September 2018 (year ended 30 September 2017: nil).

Dollars in Millions	Consolidated 30/9/18	Consolidated 30/9/17
Transactions with key management personnel		
Short term employee benefits	10	9
Termination benefits	1	-
Equity compensation benefits	2	3
Total key management personnel transactions	13	12
Loans to key management personnel	5	7
Deposits from key management personnel	4	6
Interest income on amounts due from key management personnel[1]	-	-
Interest expense on amounts due to key management personnel[1]	-	-

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

Note 24 Classification of Financial Instruments and Fair Value Measurement

Categories of financial assets and financial liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. For the purposes of this note, carrying amount refers to amounts reflected in the balance sheet. The methodologies and assumptions used in the fair value estimates are described in the Fair Value Measurement part of this note.

	Consolidated (30/9/18)			Consolidated (30/9/17)		
Dollars in Millions	**Fair Value Through Profit or Loss**	**At Amortised Cost**	**Total Carrying Amount**	Fair Value Through Profit or Loss	At Amortised Cost	Total Carrying Amount
Financial assets						
Cash and liquid assets	**-**	**2,489**	**2,489**	-	2,209	2,209
Due from central banks and other institutions	**40**	**703**	**743**	1,322	922	2,244
Trading securities	**6,842**	**-**	**6,842**	5,778	-	5,778
Derivative financial instruments	**4,336**	**-**	**4,336**	3,805	-	3,805
Loans and advances to customers	**2,824**	**80,227**	**83,051**	3,989	75,452	79,441
Amounts due from related entities	**-**	**1,253**	**1,253**	-	677	677
Other financial assets	**-**	**346**	**346**	-	288	288
Total financial assets	**14,042**	**85,018**	**99,060**	14,894	79,548	94,442
Financial liabilities						
Due to central banks and other institutions	**273**	**1,671**	**1,944**	232	1,362	1,594
Trading liabilities	**181**	**-**	**181**	247	-	247
Derivative financial instruments	**3,053**	**-**	**3,053**	3,219	-	3,219
Deposits and other borrowings	**4,964**	**58,473**	**63,437**	5,119	54,793	59,912
Bonds and notes	**19,760**	**-**	**19,760**	20,157	-	20,157
Amounts due to related entities	**-**	**913**	**913**	-	519	519
Other financial liabilities	**-**	**910**	**910**	-	589	589
Subordinated debt	**-**	**1,946**	**1,946**	-	1,824	1,824
Total financial liabilities	**28,231**	**63,913**	**92,144**	28,974	59,087	88,061

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Bonds and notes		
Balance at beginning of year	**118**	70
Movement during the year	**(60)**	48
Balance at end of year	**58**	118

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

Hierarchy for fair value measurements

The tables on page 43 present a three-level fair value hierarchy of the Banking Group's financial assets and financial liabilities which are measured at fair value or amortised cost. The fair value of the financial assets and financial liabilities are considered to approximate the carrying value disclosed in the balance sheet with the exception of loans and advances to customers, deposits and other borrowings and subordinated debt. Financial assets and financial liabilities are measured at amortised cost where the carrying value does not equal fair value.

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

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

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

The Banking Group considers transfers between levels of the fair value hierarchy, if any, to have occurred at the beginning of the respective reporting period. There were no transfers between any of the levels for the year ended 30 September 2018 (year ended 30 September 2017: nil).

Note 24 Classification of Financial Instruments and Fair Value Measurement *continued*

Hierarchy for Fair Value measurements *continued*

Financial assets and liabilities at fair value

Dollars in Millions	Fair Value Total	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3
	Consolidated (30/9/18)			
Financial assets				
Due from central banks and other institutions	40	-	40	-
Trading securities	6,842	2,817	4,025	-
Derivative financial instruments	4,336	-	4,336	-
Loans and advances to customers	2,824	-	2,824	-
Financial liabilities				
Due to central banks and other institutions	273	-	273	-
Trading liabilities	181	181	-	-
Derivative financial instruments	3,053	-	3,053	-
Deposits and other borrowings	4,964	-	4,964	-
Bonds and notes	19,760	-	19,760	-
	Consolidated (30/9/17)			
Financial assets				
Due from central banks and other institutions	1,322	-	1,322	-
Trading securities	5,778	3,275	2,503	-
Derivative financial instruments	3,805	-	3,805	-
Loans and advances to customers	3,989	-	3,989	-
Financial liabilities				
Due to central banks and other institutions	232	-	232	-
Trading liabilities	247	247	-	-
Derivative financial instruments	3,219	-	3,219	-
Deposits and other borrowings	5,119	-	5,119	-
Bonds and notes	20,157	-	20,157	-

Financial assets and liabilities at amortised cost[1]

Dollars in Millions	Carrying Value	Fair Value Total	Fair Value Level 1	Fair Value Level 2	Fair Value Level 3
	Consolidated (30/9/18)				
Financial assets					
Loans and advances to customers	80,227	80,236	-	2,562	77,674
Financial liabilities					
Deposits and other borrowings	58,473	58,672	-	58,672	-
Subordinated debt	1,946	2,012	568	1,444	-
	Consolidated (30/9/17)				
Financial assets					
Loans and advances to customers	75,452	75,452	-	2,397	73,055
Financial liabilities					
Deposits and other borrowings	54,793	54,977	-	54,977	-
Subordinated debt	1,444	1,495	568	927	-

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

Note 24 Classification of Financial Instruments and Fair Value Measurement *continued*

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

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

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

Trading securities and Trading liabilities

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

Derivative financial instruments

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

Loans and advances to customers

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

Deposits and other borrowings

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

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

Bonds and notes

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

Subordinated debt

Subordinated Loans reprice every 90 days, therefore, their fair value is considered to approximate their carrying value. For Subordinated Notes and Perpetual Notes, the fair value is estimated by discounting the expected future cash flows based on the maturity of the notes, using current market interest rates of similar types of notes. The fair value of Listed Subordinated Notes is based on quoted closing market prices as at the reporting date.

Other financial assets/liabilities

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

Note 25 Offsetting Financial Assets and Financial Liabilities

Accounting policy

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

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

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

	Consolidated (30/9/18)								
	Amounts Subject to Enforceable Netting Arrangements								
	Effect of Offsetting on Balance Sheet			Related Amounts not Offset					
Dollars in Millions	Gross Amounts	Amount Offset[1]	Net Amounts Reported in Balance Sheet	Financial Instru-ments[2]	Non-Cash Collateral[3]	Cash Collateral[3]	Net Amount	Amounts not Subject to Enforceable Netting Arrange-ments[4]	Carrying Amount
Financial assets									
Derivative financial assets	**7,015**	**3,122**	**3,893**	**2,440**	**-**	**540**	**913**	**443**	**4,336**
Collateral paid[5]	**1,123**	**642**	**481**	**-**	**-**	**154**	**327**	**-**	**481**
Reverse repurchase agreements[6]	**1,795**	**-**	**1,795**	**-**	**1,795**	**-**	**-**	**-**	**1,795**
Financial liabilities									
Derivative financial liabilities	**6,588**	**3,764**	**2,824**	**2,440**	**-**	**154**	**230**	**229**	**3,053**
Collateral received[7]	**688**	**-**	**688**	**-**	**-**	**540**	**148**	**-**	**688**
Repurchase agreements[8]	**550**	**-**	**550**	**-**	**550**	**-**	**-**	**-**	**550**
	Consolidated (30/9/17)								
Financial assets									
Derivative financial assets	5,176	1,788	3,388	2,562	-	320	506	417	3,805
Collateral paid[5]	1,223	355	868	-	-	301	567	-	868
Reverse repurchase agreements[6]	959	-	959	-	959	-	-		959
Financial liabilities									
Derivative financial liabilities	5,152	2,143	3,009	2,562	-	301	146	210	3,219
Collateral received[7]	458	-	458	-	-	320	138	-	458
Repurchase agreements[8]	222	-	222	-	222	-	-	-	222

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

[2] Financial instruments include recognised financial instruments on the balance sheet.

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

[4] Relate to items which do not have an enforceable netting arrangement in place or there is uncertainty as to the legal enforceability of a close out netting arrangement in a default or liquidation under the laws of a specific jurisdiction.

[5] Collateral paid to meet standard derivative trading obligations is reported in the balance sheet within Due from central banks and other institutions of $423 million (30 September 2017: $756 million), Loans and advances to customers of $58 million (30 September 2017: $11 million) and Related entity transactions of nil (30 September 2017: $101 million) respectively, refer to notes 9, 11 and 23 for further information.

[6] Reverse repurchase agreements are reported in the balance sheet within Cash and liquid assets of $596 million (30 September 2017: $445 million) and Amounts due from related entities of $1,199 million (30 September 2017: $514 million) respectively, refer to notes 8 and 23 for further information.

[7] Collateral received to meet standard derivative trading obligations is reported in the balance sheet within Due to central banks and other institutions of $480 million (30 September 2017: $457 million), Deposits and other borrowings of $2 million (30 September 2017: $1 million) and Related entity transactions of $206 million (30 September 2017: nil) respectively, refer to notes 17, 18 and 23 for further information.

[8] Repurchase agreements are reported in the balance sheet within Due to central banks and other institutions of $295 million (30 September 2017: $106 million) and Amounts due to related entities of $255 million (30 September 2017: $116 million) respectively, refer to notes 17 and 23 for further information.

Derivative assets and liabilities

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

Derivative amounts will only be offset on the balance sheet where the Banking Group has a legally enforceable right of offset in all circumstances and there is an intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

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

Note 25 Offsetting Financial Assets and Financial Liabilities *continued*

Reverse repurchase and repurchase agreements

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

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

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

Note 26 Transfers of Financial Assets

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

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

The RMBS Trust provides an internal residential mortgage-backed securities programme to issue securities as collateral for borrowing from the RBNZ. The Bank has transferred housing loans to the RMBS Trust which secure these securities. These housing loans have not been derecognised by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. As these housing loans have been legally transferred, the Bank does not retain the legal rights of ownership, but retains a security interest in these assets.

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

Further details on the transactions with the RMBS Trust and the Covered Bond Trust are provided in note 11.

Government bonds and securities transferred under the agreements to repurchase have not been derecognised from the balance sheet as the Bank retains substantially all the risks and rewards of ownership. The Bank's obligation to repurchase is classified under Due to central banks and other institutions. Further detail on securities sold under agreements to repurchase are provided in notes 8, 10 and 17. The fair value of these agreements is approximately equal to the carrying amount on the balance sheet due to their short term nature.

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

	Consolidated			
	Carrying Amount of Assets	Carrying Amount of Assets	**Carrying Amount of Associated Liabilities**	Carrying Amount of Associated Liabilities
Dollars in Millions	**30/9/18**	30/9/17	**30/9/18**	30/9/17
Housing loans held by RMBS Trust	**4,471**	4,471	**-**	-
Housing loans held by Covered Bond Trust	**5,051**	6,045	**4,570**	5,100
Government bonds and securities	**190**	22	**190**	22
	9,712	10,538	**4,760**	5,122

Notes to and Forming Part of the Financial Statements

Note 27 Segment Analysis

Operating segments

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

The Banking Group's business is organised into two major operating and reportable segments: Consumer and Wealth, and BNZ Partners. Consumer and Wealth provides transactional banking, savings and investment products and services, private banking, along with home loans, credit cards and personal loans to retail customers and, for management reporting purposes, includes insurance activities carried out by a controlled entity of National Australia Bank Limited that is not part of the Banking Group. BNZ Partners provides financial products and services to business, agribusiness, corporate and institutional customers.

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

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

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

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

Dollars in Millions	Consumer and Wealth [2]	BNZ Partners [2]	Total Reportable Segments	All Other Segments [2]	Other Adjustments	Total Banking Group
			Consolidated (30/9/18)			
Net interest income	**558**	**1,274**	**1,832**	**174**	**(60)**	**1,946**
Other income	**218**	**344**	**562**	**159**	**(111)**	**610**
Total operating income [1]	**776**	**1,618**	**2,394**	**333**	**(171)**	**2,556**
Operating expenses	**443**	**497**	**940**	**131**	**(26)**	**1,045**
Operating profit before credit impairment charge and income tax expense	**333**	**1,121**	**1,454**	**202**	**(145)**	**1,511**
Credit impairment charge	**21**	**55**	**76**	**-**	**6**	**82**
Operating profit before income tax expense	**312**	**1,066**	**1,378**	**202**	**(151)**	**1,429**
Total income tax expense	**88**	**300**	**388**	**52**	**(40)**	**400**
Net profit attributable to shareholder of Bank of New Zealand	**224**	**766**	**990**	**150**	**(111)**	**1,029**
Lending assets	**26,381**	**55,614**	**81,995**	**1,056**	**-**	**83,051**
Deposit liabilities	**31,023**	**25,939**	**56,962**	**2,814**	**-**	**59,776**
			Consolidated (30/9/17)			
Net interest income	515	1,178	1,693	176	(75)	1,794
Other income	213	336	549	153	(181)	521
Total operating income [1]	728	1,514	2,242	329	(256)	2,315
Operating expenses	406	466	872	102	(42)	932
Operating profit before credit impairment charge and income tax expense	322	1,048	1,370	227	(214)	1,383
Credit impairment charge	43	41	84	(13)	12	83
Operating profit before income tax expense	279	1,007	1,286	240	(226)	1,300
Total income tax expense	77	282	359	67	(63)	363
Net profit attributable to shareholders of Bank of New Zealand	202	725	927	173	(163)	937
Lending assets	23,704	54,785	78,489	952	-	79,441
Deposit liabilities	28,458	25,428	53,886	2,245	-	56,131

[1] For the year ended 30 September 2018, there were no revenues deriving from transactions with a single external customer that amounted to 10% or more of the Banking Group's revenues (30 September 2017: nil).

[2] For the year ended 30 September 2018, there has been a structural realignment of the business units in the Banking Group. As a result, the two segments have changed from 'Retail and Marketing' and 'BNZ Partners' to 'Consumer and Wealth' and 'BNZ Partners'. Revenue and expenses relating to private banking customers were reclassified from BNZ Partners to Consumer and Wealth. This reclassification was for the purpose of representing information reported to the BNZ Executive Team. Comparative balances have been reclassified.

Note 28 Contingent Liabilities and Other Commitments

Accounting policy

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

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

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

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

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

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Contingent liabilities		
Bank guarantees	**72**	79
Standby letters of credit	**301**	292
Documentary letters of credit	**120**	105
Performance related contingencies	**630**	635
Total contingent liabilities	**1,123**	1,111
Credit related commitments		
Revocable commitments to extend credit	**9,604**	8,395
Irrevocable commitments to extend credit[1]	**12,008**	11,844
Total credit related commitments	**21,612**	20,239
Total contingent liabilities and credit related commitments	**22,735**	21,350

[1] Comparative data for “Irrevocable commitments to extend credit” has been restated due to a data error in the Banking Group’s unutilised credit limit.

Contingent liabilities

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

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

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

Guarantees

The Banking Group has four principal types of guarantees:

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

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

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

Clearing and settlement obligations

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

Note 28 Contingent Liabilities and Other Commitments *continued*

Other contingent liabilities

The Labour Inspectorate of the Ministry of Business, Innovation and Employment is currently undertaking a programme of compliance audits of a number of New Zealand organisations in respect of the Holidays Act 2003 (the "Holidays Act"). The Bank requested early participation in this programme in May 2016 and received the Labour Inspectorate's final report, which sets out its findings regarding the Bank's compliance with the Holidays Act, on 18 January 2017. The findings indicated that the Bank has not complied with certain requirements of the Holidays Act, including in respect of annual and public holiday payments to certain employees. The Bank continues to review its compliance with the Holidays Act and is also working with the Labour Inspectorate to reach an appropriate resolution in respect of the issues identified in its report.

Credit related commitments

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

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

For information on the Banking Group's risk management policies, refer to note 34.

Guarantees to wholly owned controlled entities

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

Other commitments

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Capital expenditure commitments[1]	**1**	1
Land and building operating lease commitments (refer to table below)[2]	**219**	226
Fleet vehicles operating lease commitments	**11**	11
Total other commitments	**231**	238
Land and buildings operating lease commitments comprised:		
Non-cancellable future minimum lease payments:		
Due within one year	**55**	58
Due within one to five years	**135**	131
Due after five years	**29**	37
Total land and buildings lease commitments	**219**	226

[1] These capital expenditure commitments have been entered into but not provided for in these financial statements.

[2] Figures include liabilities taken up for surplus leased space.

Note 29 Credit Exposures to Connected Persons and Non-bank Connected Persons

The RBNZ defines Connected Persons to be other members of NAB and Directors of the Bank. Controlled entities of the Bank are not connected persons. Credit exposures to connected persons have been derived in accordance with the Bank's Conditions of Registration and RBNZ's Connected Exposures Policy ("BS8"). The amounts are net of specific provision for credit impairment and exclude advances of a capital nature.

Credit exposures to connected persons have been calculated on a partial bilateral net basis, netting derivative balances. Certain term loans from NAB have also been netted against derivative exposures. There is a limit of 125% of the Banking Group's Tier One capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

	Consolidated	
	$ in Millions	% of Tier One Capital As At
	30/9/18	30/9/18
As at end of year		
Credit exposure to connected persons (on gross basis, before netting)	4,157	53.9%
Credit exposure to connected persons (amount netted)	1,210	15.7%
Credit exposure to connected persons (on partial bilateral net basis)	2,947	38.2%
Credit exposure to non-bank connected persons	-	-
Peak for the year ended		
Credit exposure to connected persons (on gross basis, before netting)	4,728	61.3%
Credit exposure to connected persons (amount netted)	1,176	15.2%
Credit exposure to connected persons (on partial bilateral net basis)	3,552	46.1%
Credit exposure to non-bank connected persons	-	-

As at 30 September 2018, the Banking Group's rating-contingent limit was 60% of the Banking Group's Tier One capital. This limit has not changed during the year. Within the overall rating-contingent limit, there is a sublimit of 15% of Tier One capital that applies to aggregate credit exposures to non-bank connected persons. The rating-contingent limit on credit exposures to connected persons as set out in the Bank's Conditions of Registration has been complied with at all times during the year ended 30 September 2018. The peak for the year ended credit exposure to connected persons and non-bank connected persons are calculated by determining the maximum end-of-day aggregated amount of actual credit exposure over Banking Group's Tier One Capital as at 30 September 2018.

Where a bank is funding a large loan it is common practice to share the risk of a customer default with other connected banks. These arrangements are called risk lay-off arrangements. As at 30 September 2018, the Banking Group had no contingent credit exposures arising from risk lay-off arrangements with connected persons. There were no credit exposures to connected persons that were credit-impaired, and no provision for credit impairment on individual financial assets for connected person credit exposures as at 30 September 2018.

Note 30 Structured Entities, Securitisation, Funds Management, Fiduciary Activities and Insurance

Funds management

The Bank markets and distributes funds management products to a range of customers which are managed and issued by its wholly owned subsidiary BNZISL. Refer to note 23 for further information. The Bank provides banking services for funds management products administered by BNZISL. All arrangements are conducted on arms' length commercial terms. The Bank also provides services to a number of customers which include advice on, administration, and management of, investment portfolios.

Investments made in the Investment Schemes do not represent deposits or other liabilities of the Bank or any other member of NAB, and are subject to investment risk, including possible delays in repayment and loss of income and principal invested. None of the Bank, or any other member of NAB, the Supervisor (The New Zealand Guardian Trust Company Limited), any Director of any of them, the Crown or any other person guarantees (either fully or in part) the performance or returns of the Investment Schemes or the repayment of capital.

During the year ended 30 September 2018, the Bank held deposits on behalf of customers of JBWere (NZ) Pty Limited and JBWere (NZ) Nominees Limited. JBWere (NZ) Pty Limited and JBWere (NZ) Nominees Limited, as controlled entities of the ultimate parent, are related parties of the Banking Group, but are not a part of the Banking Group.

The outstanding value of assets related to fund management activities is set out in the table below. The assets shown below for portfolios managed on behalf of customers are not owned by the Banking Group and are, therefore, not included as part of the Banking Group's assets on the balance sheet. BNZ Cash PIE and BNZ Term PIE invest solely in debt securities issued by the Banking Group and on consolidation their assets are eliminated against liabilities recorded by the Bank. Unitholders' interests are included as part of the Banking Group's liabilities.

Dollars in Millions	30/9/18	30/9/17
Portfolios managed on behalf of customers	5,554	4,512
BNZ Cash PIE	23	38
BNZ Term PIE	1,481	1,241

Insurance business

The Banking Group does not conduct any Insurance Business, as defined by condition 3 of the Bank's Conditions of Registration set out on page 82.

Note 30 Structured Entities, Securitisation, Funds Management, Fiduciary Activities and Insurance *continued*

Marketing and distribution of insurance products

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

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

Structured entities

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

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

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

Consolidated structured entities

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

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

RMBS Trust and Covered Bond Trust

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

Further details on the transactions with the RMBS Trust and the Covered Bond Trust are provided in note 11.

Cash and Term PIE Investment Entities

The Banking Group has interests in consolidated investment entities. The Banking Group's interests are noted in the funds management section on page 50.

Unconsolidated structured entities

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

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

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

The table below shows the carrying value and maximum exposure to loss and credit quality of the Banking Group's interests in unconsolidated securitisation entities as at 30 September 2018.

	Consolidated (30/9/18)				Consolidated (30/9/17)			
Dollars in Millions	**Senior Investment Grade**	**Investment Grade**	**Sub-Investment Grade**	**Total**	Senior Investment Grade	Investment Grade	Sub-Investment Grade	Total
Carrying value of loans and advances	**653**	**11**	**3**	**667**	607	9	-	616
Commitments and guarantees	**409**	**1**	**-**	**410**	310	1	-	311
Total maximum exposure to credit loss	**1,062**	**12**	**3**	**1,077**	917	10	-	927

The total assets of unconsolidated structured entities are not considered meaningful for the purpose of understanding the Banking Group's financial risks associated with these entities and so have not been presented. Unless specified otherwise, the Banking Group's maximum exposure to loss is the total of its on-balance sheet positions and its off-balance sheet arrangements, being loan commitments, financial guarantees, and liquidity support. Exposure to loss is managed as part of the Banking Group-wide risk management framework. Refer to note 34 for further information.

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

Note 30 Structured Entities, Securitisation, Funds Management, Fiduciary Activities and Insurance *continued*

Risk management

The Banking Group has in place policies and procedures to ensure that the activities identified on pages 50 to 51 are conducted in an appropriate manner. Should adverse investment or liquidity conditions arise it is considered that the Banking Group's policies and procedures, combined with those of BNZ Life Insurance Limited and BNZ Insurance Services Limited, will minimise the possibility that those conditions will adversely impact the Banking Group. The policies and procedures referred to include comprehensive and prominent disclosure of information regarding products, formal and regular review of operations and policies by internal auditors and management, appropriate contractual agreements and compliance with contractual obligations and regulatory requirements.

The Banking Group's risk review and risk management systems are equally applicable to the marketing and distribution of products issued by the third party entities identified in the marketing and distribution of insurance products and funds management sections discussed on page 50.

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

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

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

Transactions with Banking Group entities

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

Peak aggregate funding provided to entities

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

Peak end-of-day aggregate funding (including funding provided by the purchase of securities) provided by the Banking Group to individual affiliated insurance entities and entities involved in securitisation activities, where the Banking Group is involved in the origination of securitised assets, and the marketing of securitisation schemes, is disclosed in the table below:

	Consolidated					
	Peak End-of-Day Aggregate Amount of Funding during the Year		Peak End-of-Day Aggregate Amount of Funding during the Year expressed as a Percentage of the Amount of the Entity's Assets at end of Year		Peak End-of-Day Aggregate Amount of Funding during the Year expressed as a Percentage of the Banking Group's Tier One Capital at end of Year	
Dollars in Thousands	**30/9/18**	30/9/17	**30/9/18**	30/9/17	**30/9/18**	30/9/17
Covenant Trustee Services Limited	-	195,000	-	-	-	2.7%

The above table has been compiled using gross exposures before risk lay-offs.

Note 31 Concentrations of Credit Exposures to Individual Counterparties and Groups of Closely Related Counterparties

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

	Consolidated (30/9/18) Credit Exposures to Individual Counterparties and Groups of Closely Related Counterparties Long Term Credit Rating	
Number of bank counterparties	Peak End-of-Day A-or A3 or above or its equivalent	Balance Sheet Date A-or A3 or above or its equivalent
Percentage of Common Equity Tier One capital		
10-14%	3	1
15-19%	-	-
Over 20%	3	-
Number of non-bank counterparties		
Percentage of Common Equity Tier One capital		
10-14%	2	2
15-19%	-	-
Over 20%	-	-

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

The Banking Group had no bank counterparties, supranationals or quasi-sovereign agencies with a long term credit rating below A- or A3, to whom their aggregate credit exposure, as at 30 September 2018, and peak end-of-day aggregate credit exposure, for the six months ended 30 September 2018, equalled or exceeded 10% of the Banking Group's Common Equity Tier One Capital.

The Banking Group had no non-bank counterparties with a long term credit rating below A- or A3, to whom their aggregate credit exposure, as at 30 September 2018, and peak end-of-day aggregate credit exposure, for the six months ended 30 September 2018, equalled or exceeded 10% of the Banking Group's Common Equity Tier One Capital.

Note 32 Investments in Wholly Owned Entities

Wholly owned entities of the Bank as at 30 September 2018 were:

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

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

Note 33 Capital Adequacy

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

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

RBNZ Capital Adequacy Framework (Internal Models Based Approach) ("BS2B")

The Banking Group has calculated its implied Risk-Weighted Exposure and minimum regulatory capital requirements based on BS2B for operational risk and the majority of credit risk portfolios.

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

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

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

Capital management policies

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

The Bank's Conditions of Registration require capital adequacy ratios to be calculated in accordance with BS2B. Total regulatory capital is defined as the sum of Common Equity Tier One capital, Additional Tier One capital and Tier Two capital. Tier One capital is defined as the sum of Common Equity Tier One capital and Additional Tier One capital. The Banking Group's Common Equity Tier One capital includes paid up ordinary shares and retained profits less certain deductions, Additional Tier One capital includes perpetual non-cumulative preference shares and perpetual notes and Tier Two capital includes revaluation reserves and subordinated debt.

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

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

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

For more information on the capital structure of the Banking Group, refer to page 62.

The tables on the following pages detail the capital calculation, capital ratios and capital requirements as at 30 September 2018. During the reporting period the Banking Group complied with all RBNZ's capital requirements as set out in the Bank's Conditions of Registration, except as disclosed on page 86 of this Disclosure Statement.

Note 33 Capital Adequacy *continued*

Regulatory capital

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

Dollars in Millions	Consolidated Unaudited 30/9/18
Qualifying capital	
Common Equity Tier One capital	
Contributed equity - ordinary shares	3,456
Retained profits	3,885
Accumulated other comprehensive income and other disclosed reserves	35
Deductions from Common Equity Tier One capital:	
Goodwill and other intangible assets	352
Cash flow hedge reserve	35
Credit value adjustment on liabilities designated at fair value through profit or loss	(42)
Prepaid pension assets (net of deferred tax)	4
Deferred tax asset	196
Total expected loss less total eligible allowances for impairment	21
Total Common Equity Tier One capital	6,810
Additional Tier One capital	
Subordinated debt due to related entities	900
Total Additional Tier One capital	900
Total Tier One capital	7,710
Tier Two capital	
Revaluation reserves	3
Subordinated debt due to related entities	500
Subordinated debt due to external investors	550
Total Tier Two capital	1,053
Total Tier One and Tier Two qualifying capital	8,763

Banking Group Basel III regulatory capital ratios

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

		Consolidated	
	Regulatory Minima	Unaudited 30/9/18	Unaudited[1] 30/9/17
Common Equity Tier One capital ratio	4.50%	10.56%	10.38%
Tier One capital ratio	6.00%	11.95%	11.83%
Total qualifying capital ratio	8.00%	13.59%	13.02%
Buffer ratio	2.50%	5.59%	5.02%

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

Registered Bank Basel III regulatory capital ratios

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

	The Registered Bank	
	Unaudited 30/9/18	Unaudited[2] 30/9/17
Common Equity Tier One capital ratio	10.59%	10.34%
Tier One capital ratio	11.99%	11.80%
Total qualifying capital ratio	13.62%	12.98%

[2] Comparative data for the Banking Group's capital ratios has been restated due to a data error in the Banking Group's unutilised credit limit.

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

Note 33 Capital Adequacy *continued*

Total regulatory capital requirements

Dollars in Millions	Consolidated Total Exposure at Default Unaudited 30/9/18	Risk-Weighted Exposure or Implied Risk-Weighted Exposure Unaudited 30/9/18	Total Capital Requirement[1] Unaudited 30/9/18
Credit risk			
Exposures subject to the internal ratings based approach	107,137	45,592	3,647
Equity exposures	12	49	4
Specialised lending subject to the slotting approach	8,515	8,049	644
Exposures subject to the standardised approach	2,393	980	78
Credit value adjustment subject to BS2B	N/A	1,166	93
Agribusiness supervisory adjustment[2]	N/A	1,045	84
Total credit risk	118,057	56,881	4,550
Operational risk	N/A	4,375	350
Market risk	N/A	3,236	259
Total	118,057	64,492	5,159

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

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

Advanced Internal Ratings Based approach to credit risk management

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

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

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

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

Controls surrounding credit risk rating systems

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

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

The risk-weighted asset amounts presented in the following tables include a scalar of 1.06 as required by the RBNZ in accordance with the Bank's Conditions of Registration.

Note 33 Capital Adequacy *continued*

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

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

	Consolidated					
Dollars in Millions	Weighted Average PD (%) Unaudited 30/9/18	Exposure at Default Unaudited 30/9/18	Exposure-Weighted LGD used for the Capital Calculation (%) Unaudited 30/9/18	Exposure-Weighted Risk Weight (%) Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Capital Requirement Unaudited 30/9/18
Corporate						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.05	6,552	36	15	986	79
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.31	16,771	34	41	6,890	551
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.96	14,127	35	68	9,600	768
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.48	8,280	35	91	7,522	602
Exposure-weighted PD grade > 5.0 ≤ 99.99%	9.97	1,900	41	166	3,158	252
Default PD grade = 100%	100.00	366	40	211	772	62
Total corporate exposures	1.98	47,996	35	60	28,928	2,314
Sovereign						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.03	4,830	5	1	59	4
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.38	13	45	86	11	1
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.89	18	45	106	20	2
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.24	-	45	128	-	-
Exposure-weighted PD grade > 5.0 ≤ 99.99%	5.72	-	45	147	-	-
Default PD grade = 100%	-	-	-	-	-	-
Total sovereign exposures	0.03	4,861	5	2	90	7
Bank						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.04	5,885	41	17	1,002	80
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.17	559	46	44	248	20
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.80	18	60	99	16	1
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.45	64	60	172	111	9
Exposure-weighted PD grade > 5.0 ≤ 99.99%	6.26	-	60	202	-	-
Default PD grade = 100%	-	-	-	-	-	-
Total bank exposures	0.08	6,526	42	21	1,377	110
Residential mortgage						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.03	-	38	6	-	-
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.40	1,634	18	14	233	19
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.92	39,345	20	28	10,843	867
Exposure-weighted PD grade > 1.5 ≤ 5.0%	4.92	2,148	19	71	1,532	123
Exposure-weighted PD grade > 5.0 ≤ 99.99%	-	-	-	-	-	-
Default PD grade = 100%	100.00	185	22	259	480	38
Total residential mortgage exposures	1.52	43,312	20	30	13,088	1,047
Other retail[1]						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.05	758	86	13	99	8
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.25	612	85	41	250	20
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.95	427	84	87	370	29
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.86	346	85	122	422	34
Exposure-weighted PD grade > 5.0 ≤ 99.99%	12.13	142	82	151	214	17
Default PD grade = 100%	100.00	12	78	306	35	3
Total other retail exposures	1.94	2,297	85	61	1,390	111

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

Note 33 Capital Adequacy *continued*

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

	Consolidated					
Dollars in Millions	Weighted Average PD (%) Unaudited 30/9/18	Exposure at Default Unaudited 30/9/18	Exposure-Weighted LGD used for the Capital Calculation (%) Unaudited 30/9/18	Exposure-Weighted Risk Weight (%) Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Capital Requirement Unaudited 30/9/18
Retail small to medium enterprises						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.07	132	36	7	10	1
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.30	654	29	16	105	8
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.97	627	31	33	204	16
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.63	651	33	48	310	25
Exposure-weighted PD grade > 5.0 ≤ 99.99%	10.50	54	40	72	39	4
Default PD grade = 100%	100.00	27	42	189	51	4
Total retail SME exposures	2.71	2,145	32	34	719	58
Total[1]						
Exposure-weighted PD grade > 0 ≤ 0.1%	0.04	18,157	31	12	2,156	172
Exposure-weighted PD grade > 0.1 ≤ 0.5%	0.31	20,243	34	38	7,737	619
Exposure-weighted PD grade > 0.5 ≤ 1.5%	0.93	54,562	25	39	21,053	1,683
Exposure-weighted PD grade > 1.5 ≤ 5.0%	2.96	11,489	34	86	9,897	793
Exposure-weighted PD grade > 5.0 ≤ 99.99%	10.13	2,096	44	163	3,411	273
Default PD grade = 100%	100.00	590	35	227	1,338	107
Total exposures	1.60	107,137	29	43	45,592	3,647

[1] The BS2B credit value adjustment has not been included in the above exposures.

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

	Consolidated			
Dollars in Millions	Total Exposure Unaudited 30/9/18	Exposure at Default Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Capital Requirement Unaudited 30/9/18
On-balance sheet exposures				
Corporate	34,810	34,810	21,822	1,745
Sovereign	4,351	4,351	69	5
Bank	4,491	4,491	908	73
Residential mortgage	39,728	39,728	12,081	966
Other retail	1,325	1,325	1,006	80
Retail small to medium enterprises	1,621	1,621	564	45
Total on-balance sheet exposures	86,326	86,326	36,450	2,914
Off-balance sheet exposures				
Corporate	12,339	11,169	6,259	501
Sovereign	153	70	11	1
Bank	738	719	84	7
Residential mortgage	4,071	3,584	1,007	81
Other retail	2,808	972	384	31
Retail small to medium enterprises	573	524	155	12
Total off-balance sheet exposures	20,682	17,038	7,900	633
Market related contracts				
Corporate	220,925	2,017	846	68
Sovereign	17,886	440	10	1
Bank	157,473	1,316	386	31
Total market related contracts	396,284	3,773	1,242	100

Note 33 Capital Adequacy *continued*

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

	Consolidated			
	Total Exposure Unaudited	Exposure at Default Unaudited	Risk-Weighted Assets Unaudited	Minimum Capital Requirement Unaudited
Dollars in Millions	30/9/18	30/9/18	30/9/18	30/9/18
Summary[1]				
Corporate	268,074	47,996	28,927	2,314
Sovereign	22,390	4,861	90	7
Bank	162,702	6,526	1,378	111
Residential mortgage	43,799	43,312	13,088	1,047
Other retail	4,133	2,297	1,390	111
Retail small and medium enterprises	2,194	2,145	719	57
Total credit risk exposures subject to the IRB approach	503,292	107,137	45,592	3,647

1 The BS2B credit value adjustment has not been included in the above exposures.

Equity exposures

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

	Consolidated			
	Exposure at Default Unaudited	Risk Weight (%) Unaudited	Risk-Weighted Exposures Unaudited	Minimum Pillar One Capital Requirement Unaudited
Dollars in Millions	30/9/18	30/9/18	30/9/18	30/9/18
Equity holdings (not deducted from capital) that are publicly traded	-	300	-	-
All other equity holdings (not deducted from capital)	12	400	49	4
Total equity exposures	12	400	49	4

Specialised lending subject to the slotting approach

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

	Consolidated			
	Total Exposure at Default after Credit Risk Mitigation Unaudited	Risk Weight (%) Unaudited	Risk-Weighted Assets Unaudited	Minimum Pillar One Capital Requirement Unaudited
Dollars in Millions	30/9/18	30/9/18	30/9/18	30/9/18
On-balance sheet exposures subject to the slotting approach				
Strong	1,575	70	1,169	94
Good	4,879	90	4,651	372
Satisfactory	907	115	1,101	88
Weak	51	250	134	11
Default	70	-	-	-
Total on-balance sheet exposures subject to the slotting approach	7,482	89	7,055	565

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

The calculated risk-weighted assets reflected above include the required scalar of 1.06, specified in the Bank's Conditions of Registration, which is not reflected in the risk weight shown.

Note 33 Capital Adequacy *continued*

Dollars in Millions	Total Exposure Unaudited 30/9/18	Exposure At Default Unaudited 30/9/18	Average Risk Weight (%) Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Pillar One Capital Requirement Unaudited 30/9/18
	Consolidated				
Off-balance sheet exposures subject to the slotting approach					
Off-balance sheet exposures	44	18	94	17	1
Undrawn commitments	1,741	955	98	933	74
Market related contracts	1,559	55	80	44	4
Total off-balance sheet exposures subject to the slotting approach	3,344	1,028	97	994	79
Total exposures subject to the slotting approach		8,510	90	8,049	644

Credit risk exposures subject to the standardised approach

The tables below show credit risk exposures, for which the standardised approach has been used.

Dollars in Millions	Total Exposure at Default after Credit Risk Mitigation Unaudited 30/9/18	Average Risk Weight (%) Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Pillar One Capital Requirement Unaudited 30/9/18
	Consolidated			
On-balance sheet exposures subject to the standardised approach				
Corporate	211	106	223	18
Residential mortgage	61	90	54	4
Past due assets	4	159	6	1
Other assets[1]	1,256	40	502	40
Total on-balance sheet exposures subject to the standardised approach	1,532	51	785	63

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

Dollars in Millions	Total Exposure or Principal Amount Unaudited 30/9/18	Average Credit Conversion Factor (%) Unaudited 30/9/18	Credit Equivalent Amount Unaudited 30/9/18	Average Risk Weight (%) Unaudited 30/9/18	Risk-Weighted Assets Unaudited 30/9/18	Minimum Pillar One Capital Requirement Unaudited 30/9/18
	Consolidated					
Off-balance sheet exposures subject to the standardised approach						
Total off-balance sheet exposures subject to the standardised approach	91	28	25	91	23	2
Market related contracts subject to the standardised approach						
Foreign exchange contracts	8	N/A	-	106	-	-
Interest rate contracts[2]	533,486	N/A	835	20	172	13
Other	13	N/A	1	2	-	-
Total market related contracts subject to the standardised approach	533,507	N/A	836	21	172	13
Total exposures subject to the standardised approach		N/A	2,393	41	980	78

[2] The total exposure or principal amount reflects the gross notional value of contracts transacted through a qualifying central counterparty ("QCCP").

Note 33 Capital Adequacy *continued*

Credit risk mitigation

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

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

	Consolidated
	Corporate (Including Specialised Lending) Unaudited
Dollars in Millions	30/9/18
For portfolios subject to the standardised approach:	
Total value of exposures covered by eligible financial or IRB collateral	6
For all portfolios:	
Total value of exposures covered by credit derivatives or guarantees	-

Residential mortgages by loan-to-valuation ratio

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

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

		Consolidated	
	On-balance Sheet Exposures at Default Unaudited	Off-balance Sheet Exposures at Default[1] Unaudited	Total Exposures at Default Unaudited
Dollars in Millions	30/9/18	30/9/18	30/9/18
LVR Range			
0-59%	16,676	1,353	18,029
60-69%	8,915	710	9,625
70-79%	11,549	1,024	12,573
80-89%	1,497	24	1,521
Over 90%	1,091	473	1,564
Total exposures at default secured by residential mortgages	39,728	3,584	43,312

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

	Consolidated
	On-balance Sheet Exposures at Default Unaudited
Dollars in Millions	30/9/18
Reconciliation of exposures secured by residential mortgages to housing loans in note 11 Loans and advances to customers	
Loans and advances to customers - housing loans	39,727
Add: Partial write offs excluded under the IRB approach	1
Total exposures secured by residential mortgages	39,728

Operational risk

	Consolidated	
	Implied Risk-Weighted Exposure Unaudited	Total Operational Risk Capital Requirement Unaudited
Dollars in Millions	30/9/18	30/9/18
Operational risk	4,375	350

The operational risk capital requirement above has been calculated under the Advanced Measurement Approach (“AMA”) which the Banking Group uses for determining its regulatory capital for operational risk together with any required regulatory adjustments. The AMA is in accordance with BS2B.

Note 33 Capital Adequacy *continued*

Market risk

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

	Consolidated Unaudited (30/9/18)			
	Implied Risk-Weighted Exposure		Aggregate Capital Charge	
Dollars in Millions	End of Period	Peak End-of-Day	End of Period	Peak End-of-Day
Interest rate risk	3,215	3,983	257	319
Foreign exchange risk	9	66	1	5
Equity risk	12	12	1	1
Total market risk	3,236	4,061	259	325

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

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

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

Capital for other material risks

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

As at 30 September 2018, the Banking Group had an internal capital allocation for strategic business risk of $109 million (30 September 2017: $111 million).

Capital structure

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

Subordinated debt
Refer to note 21 for further information.

National Australia Bank Limited capital adequacy

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

	Ultimate Parent Banking Group		Ultimate Parent Bank	
	Unaudited	Unaudited	**Unaudited**	Unaudited
	30/9/18	30/9/17	**30/9/18**	30/9/17
Common Equity Tier One capital ratio	**10.20%**	10.06%	**10.43%**	10.37%
Tier One capital ratio	**12.38%**	12.41%	**12.78%**	12.96%
Total qualifying capital ratio	**14.12%**	14.58%	**14.65%**	15.26%

The ultimate parent banking group data is the Level 2 capital ratio (as published in the National Australia Bank Limited Pillar 3 report) and represents the consolidation of NAB and all its subsidiary entities, other than the non-consolidated subsidiaries as outlined in the Pillar 3 report. The Level 2 Group operates in multiple regulatory jurisdictions and applies a combination of Basel capital framework and standardised approaches depending on the prescribed prudential requirements within those jurisdictions. Further information on the Basel capital framework methodologies applied across the ultimate parent banking group is outlined in the Pillar 3 report.

The ultimate parent bank of the Banking Group is National Australia Bank Limited which reports under the Advanced approach for credit risk (other than for defined assets that are immaterial in terms of risk-weighted assets or are not required to be treated as IRB under the Basel capital framework), and the AMA for operational risk. The ultimate parent bank capital ratios are effectively represented by the Level 1 capital ratios, which comprises National Australia Bank Limited and its subsidiary entities approved by APRA as part of the Extended Licensed Entity.

Under prudential regulations, NAB is required to hold capital above the prudential capital ratio ("PCR") as determined by APRA for both the Level 1 and Level 2 Groups. The PCR is prescribed on a bilateral basis, and is not publicly disclosed. National Australia Bank Limited met the minimum capital adequacy requirements set by APRA as at 30 September 2018.

National Australia Bank Limited is required to publicly disclose risk management and capital adequacy information as at the reporting date, as specified in APRA's Pillar 3 Prudential Standard APS 330 Capital Adequacy: Public Disclosure ("APS 330"). Updates are provided on a semi-annual and quarterly basis in accordance with the APS 330 reporting requirements.

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

Notes to and Forming Part of the Financial Statements

Note 34 Risk Management

Risk Management

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

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

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

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

The key risks faced by the Banking Group include:

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

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

Board governance

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

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

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

Executive governance

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

Internal audit function

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

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

External auditor and credit rating agencies

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

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

Note 34 Risk Management *continued*

Credit risk

Credit risk is the risk of financial loss resulting from the failure of customers to settle their financial and contractual obligations to the Banking Group as they fall due.

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

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

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

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

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

The following section discloses the Bank's policies and procedures for collateral taken to mitigate credit risk.

Cash and liquid assets

Cash and liquid assets comprises primarily collateral on securities borrowing and reverse repurchase agreements with financial institutions, which are permitted to be sold or re-pledged. Securities borrowing and reverse repurchase agreements are collateralised with highly liquid securities which are permitted to be sold or re-pledged. The fair values of this collateral are disclosed in note 8.

Due from central banks and other institutions

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

Trading securities

The Banking Group has not accepted any collateral for Trading securities. The Banking Group may utilise credit derivatives, guarantees provided by central banks or other forms of credit enhancements or collateral in order to minimise the Banking Group's exposure to credit risk.

Derivative financial instruments

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

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

Gross loans and advances to customers

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

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

Housing loans are secured by mortgages over residential properties. LVR thresholds range up to, or exceed 100% in limited circumstances, including remediation of damaged properties that are held by the Banking Group as security. Further details on LVR are provided in note 33.

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

Amounts due from related entities

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

Note 34 Risk Management *continued*

Credit risk *continued*

Credit quality of financial assets

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

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

Defaulted assets consist of retail loans (excluding unsecured portfolio managed facilities) and non-retail loans which are at least 90 days past due on any material obligation.

Impaired assets under the expected credit loss model consist of:

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

An asset will migrate down the ECL stages as asset quality deteriorates by comparing the credit risk rating of the asset at reporting date with its credit risk rating at origination using the Banking Group’s internal credit rating system. The trigger to move down an ECL stage is based on a pre-determined ratings downgrade shift that determines whether significant deterioration has occurred. Conversely, assets will migrate up an ECL stage as asset quality improves.

Credit risk exposures by risk grade

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

- Senior investment grade: broadly corresponds with Standard & Poor’s ratings of AAA to A-;
- Investment grade: broadly corresponds with Standard & Poor’s ratings of BBB+ to BBB-;
- Sub-investment grade: broadly corresponds with Standard & Poor’s ratings of BB+; and
- Default: broadly corresponds with Standard & Poor’s rating of D.

	Consolidated (30/9/18)			
	Loans and advances and loan commitments for which the loss allowance is measured at:			
Dollars in Millions	**12-months ECL**	**Lifetime ECL Not Credit Impaired**	**Lifetime ECL Credit Impaired**	**Total**
Credit risk exposure by risk grade				
Senior investment grade	**28,340**	**220**	**-**	**28,560**
Investment grade	**27,885**	**2,855**	**-**	**30,740**
Sub-investment grade	**24,086**	**19,334**	**-**	**43,420**
Default	**-**	**-**	**697**	**697**
Total credit risk exposure by risk grade	**80,311**	**22,409**	**697**	**103,417**
	Consolidated (30/9/17)			
Credit risk exposure by risk grade [1]				
Senior investment grade	25,749	-	-	25,749
Investment grade	29,301	1,292	-	30,593
Sub-investment grade	22,530	17,543	-	40,073
Default	-	-	853	853
Total credit risk exposure by risk grade	77,580	18,835	853	97,268

[1] Comparative data has been restated due to a data error in the Banking Group's unutilised credit limit.

Note 34 Risk Management *continued*

Concentrations of credit exposure

The Banking Group's concentrations of credit exposure are reported by geographical location and industry sector in the table below. The concentrations of credit exposure by geographical location is based on the geographical location of the counterparty's tax residency. The concentrations of credit exposure by industry sector is based on ANZSIC codes.

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

	Consolidated			Consolidated		
	On-balance sheet	**Off-balance sheet[1]**	**Total exposure**	On-balance sheet	Off-balance sheet[1]	Total exposure
Dollars in Millions	**30/9/18**	**30/9/18**	**30/9/18**	30/9/17	30/9/17	30/9/17
Concentration by industry						
Agriculture	**14,727**	**1,069**	**15,796**	14,386	1,111	15,497
Forestry and fishing	**970**	**223**	**1,193**	932	234	1,166
Mining	**238**	**224**	**462**	257	252	509
Manufacturing	**3,754**	**1,644**	**5,398**	3,190	1,439	4,629
Electricity, gas and water	**909**	**488**	**1,397**	1,067	870	1,937
Construction	**1,148**	**736**	**1,884**	1,034	427	1,461
Wholesale and retail trade	**3,622**	**1,422**	**5,044**	3,798	1,529	5,327
Accommodation, restaurants, culture and recreation	**1,381**	**453**	**1,834**	1,236	374	1,610
Transport and storage	**2,114**	**609**	**2,723**	1,685	677	2,362
Communications	**244**	**260**	**504**	267	247	514
Financial, investment and insurance[2]	**8,962**	**1,235**	**10,197**	9,999	897	10,896
Property, business and personal services	**10,624**	**1,859**	**12,483**	10,325	1,964	12,289
Government, education, health and community services[2]	**6,421**	**1,134**	**7,555**	5,529	1,181	6,710
Real estate - mortgage	**39,727**	**1,739**	**41,466**	37,358	1,700	39,058
Personal lending	**1,447**	**36**	**1,483**	1,445	53	1,498
Related entities[3]	**2,749**	**-**	**2,749**	1,971	-	1,971
Total credit exposures by industry	**99,037**	**13,131**	**112,168**	94,479	12,955	107,434
Concentration by geography						
New Zealand	**92,211**	**13,060**	**105,271**	88,308	12,911	101,219
Overseas	**6,826**	**71**	**6,897**	6,171	44	6,215
Total credit exposures by geography	**99,037**	**13,131**	**112,168**	94,479	12,955	107,434

[1] Off-balance sheet credit exposures include contingent liabilities and irrevocable commitments to extend credit. Comparative data for off-balance sheet has been restated due to a data error in the Banking Group's unutilised credit limit.

[2] Comparative data has been restated to reflect a correction in industry classification for government stock from "Financial, investment and insurance" to "Government, education, health and community services".

[3] Related entities include amounts due from related entities and derivative financial assets with related entities.

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
Maximum exposure to credit risk		
Cash and liquid assets	**2,326**	2,071
Due from central banks and other institutions	**743**	2,244
Trading securities	**6,842**	5,778
Derivative financial instruments	**4,336**	3,805
Gross loans and advances to customers	**83,537**	79,904
Amounts due from related entities	**1,253**	677
Total on-balance sheet credit exposures	**99,037**	94,479
Off-balance sheet credit exposures	**13,131**	12,955
Total maximum exposure to credit risk	**112,168**	107,434

Notes to and Forming Part of the Financial Statements

Note 34 Risk Management *continued*

Derivatives

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

Undrawn credit commitments

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

Operational and compliance risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people, systems or from external events. The Banking Group has adopted the NAB Group's Operational Risk Framework, which sets out the principles for managing operational risks across the Banking Group.

Compliance risk is the risk of legal or regulatory sanctions resulting from failure to understand and comply with laws, regulations, licence conditions, supervisory requirements, and self-regulatory industry codes of conduct, as well as internal policies, procedures, organisational frameworks and standards. The NAB compliance framework sets out the principles for managing compliance risks across the Banking Group.

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

The primary roles of the Banking Group's Risk division in relation to operational and compliance risk are policy making; advisory and support, including monitoring and oversight; the assessment of new and re-engineered products and processes; business continuity; risk measurement and control; and reporting. The team also provides subject matter expertise and additional assistance to business units and identifies systemic trends across the business.

The Banking Group is accredited by the RBNZ to use the Advanced Measurement Approach ("AMA") for operational risk. As a result, the Bank calculates its operational risk implied risk-weighted exposure and resultant capital requirement (including any required regulatory adjustments) as required by the RBNZ's Capital Adequacy Framework (Internal Models Based Approach) ("BS2B").

The Banking Group's quantitative operational risk measurement approach is based on the AMA and uses the factors below to estimate the aggregate loss distribution for total operational risk losses over a 12-month horizon:

- internal loss data;
- relevant external loss data;
- consideration of the Bank's business environment and controls; and
- the outputs of a scenario analysis process.

The operational risk calculations are performed on an aggregate Bank-wide basis, and the resultant capital is allocated across major business lines. At present, no adjustment is made to regulatory capital to account for expected losses, or for the mitigating effect of the Bank's insurance programme.

Conduct risk is inherent in the Banking Group's business activities. Conduct risk is the risk of the Banking Group intentionally or unintentionally treating its customers unfairly and delivering negative outcomes for customers, clients, counterparties, investors, shareholders and the markets in which the Banking Group operates resulting from inappropriate, unlawful or unethical judgements made during the execution of the Banking Group's business activities. Conduct Risk is managed by leveraging policies, processes and tools used for other material risk types, such as operational risk, compliance risk and regulatory risk, and through the Banking Group's conduct strategy. Governance and oversight of conduct risk and the conduct strategy resides with the Conduct Council, a sub-committee of the Banking Group's RRMC. For capital adequacy purposes, conduct risk is part of the calculation of operational risk capital.

Note 34 Risk Management *continued*

Strategy in using financial instruments

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

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

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

Market risk - traded

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

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

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

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

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

All trading activities are subject to the disciplines prescribed in the National Australia Bank Group Traded Market Risk Policy which is approved by the National Australia Bank Limited Board. This includes the use of the Value at Risk ("VaR") methodology.

Objectives and limitations of the VaR methodology

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

VaR is calculated using the historical simulation method. This method involves multiple revaluations of the trading books using two years of historical pricing shifts. The pricing data is updated daily so as to have the most recent two-year history of prices. The results are ranked and the loss at the 99th percentile confidence interval identified. The calculation and rate shifts used assume a one day holding period for all positions.

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

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

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

Note 34 Risk Management *continued*

Market risk - traded *continued*

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

	Consolidated							
	As At		Average Value During Year		Minimum Value During Year		Maximum Value During Year	
Dollars in Millions	30/9/18	30/9/17	30/9/18	30/9/17	30/9/18	30/9/17	30/9/18	30/9/17
VaR at a 99% confidence level								
Foreign exchange risk	0.07	0.47	0.32	0.48	0.02	0.06	1.39	1.44
Interest rate risk	0.99	2.59	1.95	2.25	0.91	0.76	3.73	4.68
Volatility risk	-	0.01	0.01	0.03	-	-	0.07	0.07
Credit spread risk	0.23	0.23	0.25	0.29	0.13	0.18	0.53	0.54
Diversification benefit	(0.36)	(0.78)	(0.54)	(0.69)	(0.16)	(0.12)	(1.81)	(1.75)
Total VaR for physical and derivative positions	0.93	2.52	1.99	2.36	0.90	0.88	3.91	4.98

VaR is measured individually for foreign exchange risk, interest rate risk, volatility, commodities and credit spread risk. The individual risk categories do not sum up to the total risk number due to diversification benefits.

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

Foreign exchange risk

Foreign exchange risk is the risk due to changes in foreign exchange rates.

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

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

Net open position

	Consolidated	
Dollars in Millions	30/9/18	30/9/17
US dollar	(6)	(7)
Australian dollar	4	15
Japanese yen	2	(5)
Pound sterling	-	2
Euro	-	(15)
Swiss franc	1	-
Other	1	1

Market risk – non-traded/banking positions

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

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

Non-traded market risk policies are approved by the NAB Board and noted by the relevant BNZ risk committee.

Note 34 Risk Management *continued*

Interest rate risk

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

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

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

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

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

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

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
VaR for physical and derivative positions at a 99% confidence level		
New Zealand		
As at end of year	**11**	9
Average value during year ended	**16**	14
Minimum value during year ended	**8**	8
Maximum value during year ended	**25**	25

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

	Consolidated	
Dollars in Millions	**30/9/18**	30/9/17
EaR for physical and derivative positions at a 99% confidence level		
New Zealand		
As at end of year	**8**	7
Average value during year ended	**8**	8
Minimum value during year ended	**4**	4
Maximum value during year ended	**13**	13

Note 34 Risk Management *continued*

Interest rate repricing schedule

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

	Consolidated (30/9/18)						
Dollars in Millions	Total	Up to 3 Months	Over 3 Months and up to 6 Months	Over 6 Months and up to 1 Year	Over 1 Year and up to 2 Years	Over 2 Years	Non-Interest Bearing
Assets							
Cash and liquid assets	2,489	2,057	-	-	-	-	432
Due from central banks and other institutions	743	722	21	-	-	-	-
Trading securities	6,842	2,394	1,273	764	614	1,797	-
Derivative financial instruments	4,336	-	-	-	-	-	4,336
Gross loans and advances to customers	83,537	48,092	4,451	11,292	12,884	5,008	1,810
Deductions from loans and advances to customers	(486)	-	-	-	-	-	(486)
Amounts due from related entities	1,253	1,217	-	-	-	-	36
All other assets	1,277	-	-	-	-	-	1,277
Total assets	99,991	54,482	5,745	12,056	13,498	6,805	7,405
Liabilities							
Due to central banks and other institutions	1,944	1,864	4	30	35	9	2
Trading liabilities	181	-	-	-	27	154	-
Derivative financial instruments	3,053	-	-	-	-	-	3,053
Deposits and other borrowings	63,437	37,566	9,634	7,406	1,843	1,207	5,781
Bonds and notes	19,760	4,271	1,512	1,157	1,360	11,460	-
Amounts due to related entities	913	795	-	-	-	-	118
Subordinated debt	1,946	500	-	-	-	1,446	-
All other liabilities	1,378	-	-	-	-	-	1,378
Total liabilities	92,612	44,996	11,150	8,593	3,265	14,276	10,332
Shareholder's equity							
Total shareholder's equity	7,379	-	-	-	-	-	7,379
Total liabilities and shareholder's equity	99,991	44,996	11,150	8,593	3,265	14,276	17,711
On-balance sheet sensitivity gap	-	9,486	(5,405)	3,463	10,233	(7,471)	(10,306)
Derivative financial instruments[1]							
Net balance of derivative financial instruments	-	(18,042)	11,716	(2,640)	(2,178)	11,144	-
Interest sensitivity gap - net	-	(8,556)	6,311	823	8,055	3,673	(10,306)
Interest sensitivity gap - cumulative	-	(8,556)	(2,245)	(1,422)	6,633	10,306	-

[1] The Banking Group has revised its methodology to calculate the net balance of derivative financial instruments. Comparative balances have been restated.

Note 34 Risk Management *continued*

Interest rate repricing schedule *continued*

	Consolidated (30/9/17)						
Dollars in Millions	Total	Up to 3 Months	Over 3 Months and up to 6 Months	Over 6 Months and up to 1 Year	Over 1 Year and up to 2 Years	Over 2 Years	Non-Interest Bearing
Assets							
Cash and liquid assets	2,209	1,863	-	-	-	-	346
Due from central banks and other institutions	2,244	2,221	23	-	-	-	-
Trading securities	5,778	2,418	1,239	663	840	618	-
Derivative financial instruments	3,805	-	-	-	-	-	3,805
Gross loans and advances to customers	79,904	45,064	3,697	8,037	12,691	8,772	1,643
Deductions from loans and advances to customers	(463)	-	-	-	-	-	(463)
Amounts due from related entities	677	637	-	-	-	-	40
All other assets	1,161	-	-	-	-	-	1,161
Total assets	95,315	52,203	4,959	8,700	13,531	9,390	6,532
Liabilities							
Due to central banks and other institutions	1,594	1,519	1	26	13	34	1
Trading liabilities	247	10	-	-	-	237	-
Derivative financial instruments	3,219	-	-	-	-	-	3,219
Deposits and other borrowings	59,912	35,686	9,330	6,944	1,835	1,030	5,087
Bonds and notes	20,157	5,505	1,759	828	3,106	8,959	-
Amounts due to related entities	519	383	-	-	-	-	136
Subordinated debt	1,824	380	-	-	-	1,444	-
All other liabilities	902	-	-	-	-	-	902
Total liabilities	88,374	43,483	11,090	7,798	4,954	11,704	9,345
Shareholder's equity							
Total shareholder's equity	6,941	-	-	-	-	-	6,941
Total liabilities and shareholder's equity	95,315	43,483	11,090	7,798	4,954	11,704	16,286
On-balance sheet sensitivity gap	-	8,720	(6,131)	902	8,577	(2,314)	(9,754)
Derivative financial instruments							
Net balance of derivative financial instruments	-	(10,821)	6,762	2,920	(3,297)	4,436	-
Interest sensitivity gap - net	-	(2,101)	631	3,822	5,280	2,122	(9,754)
Interest sensitivity gap - cumulative	-	(2,101)	(1,470)	2,352	7,632	9,754	-

Equity risk

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

Liquidity risk

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

Maintaining adequate liquidity to meet current and future payment obligations at a reasonable cost is a core objective of the Banking Group.

The following are types of liquidity risks:

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

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

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

Note 34 Risk Management *continued*

Liquidity risk *continued*

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

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

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

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

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

Maturity profile

The tables on pages 73 and 74 present the Banking Group's cash flows by remaining contractual maturities as at the reporting date.

The gross cash flows disclosed hereafter are the contractual undiscounted cash flows and include both principal and associated future interest payments and therefore will not agree to the carrying values on the balance sheet. Actual cash flows can differ significantly from contractual cash flows as a result of future actions of the Banking Group and its counterparties. Off-balance sheet exposures are excluded from the tables below as contractual cash flows, if any, are contingent in nature. Irrevocable commitments to extend credit can be drawn down at any time before the commitments expire. Details of off-balance sheet exposures are included in note 28. Other assets and other liabilities only include balances which have contractual future cash flows.

	Consolidated (30/9/18)					
Dollars in Millions	On Demand	3 Months or less	3 to 12 Months	1 to 5 Years	Over 5 Years	Total Inflow/ (Outflow)
Assets						
Cash and liquid assets	1,894	596	-	-	-	2,490
Due from central banks and other institutions	-	723	22	-	-	745
Trading securities	-	2,101	2,171	2,221	589	7,082
Loans and advances to customers	6,573	17,373	11,596	27,775	47,611	110,928
Amounts due from related entities	22	1,217	14	-	-	1,253
Other assets	-	455	-	-	-	455
Total	8,489	22,465	13,803	29,996	48,200	122,953
Liabilities						
Due to central banks and other institutions	(914)	(952)	(34)	(47)	-	(1,947)
Trading liabilities	-	(1)	(3)	(42)	(150)	(196)
Deposits and other borrowings	(25,545)	(16,786)	(18,545)	(3,237)	-	(64,113)
Bonds and notes	-	(750)	(3,527)	(13,457)	(3,118)	(20,852)
Amounts due to related entities	(356)	(557)	-	-	-	(913)
Other liabilities	-	(696)	-	-	-	(696)
Subordinated debt	-	(78)	(32)	(1,402)	(915)	(2,427)
Total	(26,815)	(19,820)	(22,141)	(18,185)	(4,183)	(91,144)
Derivative financial liabilities[1]						
Derivative financial liabilities inflow	-	35,891	10,016	18,456	6,597	70,960
Derivative financial liabilities (outflow)	-	(37,207)	(11,677)	(22,625)	(7,166)	(78,675)

[1] Derivative financial liabilities includes hedging and trading derivative cash flows.

Note 34 Risk Management *continued*

Maturity profile *continued*

Dollars in Millions	On Demand	3 Months or less	3 to 12 Months	1 to 5 Years	Over 5 Years	Total Inflow/ (Outflow)
	Consolidated (30/9/17)					
Assets						
Cash and liquid assets	1,764	445	-	-	-	2,209
Due from central banks and other institutions	-	2,222	23	-	-	2,245
Trading securities	-	2,305	2,060	1,284	229	5,878
Loans and advances to customers	6,096	16,847	10,592	27,333	44,931	105,799
Amounts due from related entities	25	637	15	-	-	677
Other assets	-	429	-	-	-	429
Total	7,885	22,885	12,690	28,617	45,160	117,237
Liabilities						
Due to central banks and other institutions	(816)	(707)	(29)	(47)	-	(1,599)
Trading liabilities	-	(11)	(5)	(25)	(244)	(285)
Deposits and other borrowings	(23,596)	(15,956)	(17,941)	(3,040)	-	(60,533)
Bonds and notes	-	(1,857)	(3,324)	(13,121)	(2,770)	(21,072)
Amounts due to related entities	(301)	(218)	-	-	-	(519)
Other liabilities	-	(717)	-	-	-	(717)
Subordinated debt	-	(70)	(28)	(395)	(1,942)	(2,435)
Total	(24,713)	(19,536)	(21,327)	(16,628)	(4,956)	(87,160)
Derivative financial liabilities[1]						
Derivative financial liabilities inflow	-	20,904	9,807	16,708	6,104	53,523
Derivative financial liabilities (outflow)	-	(22,129)	(11,072)	(19,489)	(6,562)	(59,252)

[1] Derivative financial liabilities includes hedging and trading derivative cash flows.

Liquidity portfolio management

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

Dollars in Millions	**Consolidated 30/9/18**	30/9/17
Cash and balances immediately convertible to cash[1]	**1,903**	3,035
Net securities purchased under agreements to resell	**1,064**	490
Government bonds, notes and securities	**2,817**	3,275
Semi-government bonds, notes and securities	**2,037**	843
Corporate and other institution bonds, notes and securities	**1,988**	1,660
Total liquidity portfolio	**9,809**	9,303

[1] Included within Cash and balances immediately convertible to cash is $10 million due from other institutions (30 September 2017: $1,271 million).

As at 30 September 2018, the Banking Group also held unencumbered RMBS of $4,491 million (30 September 2017: $4,491 million) of which $4,300 million are available to be sold to the RBNZ under agreements to repurchase for liquidity purposes, which are subject to a 19% reduction in value (net $3,483 million). These RMBS are secured by residential housing loans and other assets. Refer to note 11 for further information. The Banking Group had not entered into any repurchase agreements for RMBS with the RBNZ as at 30 September 2018 (30 September 2017: nil).

Regulatory liquidity ratios

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

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

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

The one-year core funding ratio measures the extent to which loans and advances are funded by funding that is considered stable. The one-year core funding ratio = 100 x (one-year core funding dollar amount / BS13 total loans and advances) and must currently remain above 75 percent on a daily basis.

Note 34 Risk Management *continued*

Regulatory liquidity ratios *continued*

	Consolidated Unaudited For the 3 months ended 30/9/18	Consolidated Unaudited For the 3 months ended 30/6/18
One-week mismatch ratio	**4.7%**	4.4%
One-month mismatch ratio	**5.9%**	5.3%
One-year core funding ratio	**87.3%**	87.0%

Concentrations of funding

The Banking Group's concentrations of funding is reported by geographical location and industry sector in the following table. The concentrations of funding by geographical location is based on the geographical location of the office in which the funds are recognised. The concentrations of funding by industry sector is based on Australian and New Zealand Standard Industrial Classification ("ANZSIC") codes.

Dollars in Millions	Note	Consolidated 30/9/18	Consolidated 30/9/17
Concentration by industry			
Customer deposits			
Agriculture, forestry and fishing		**2,757**	2,600
Mining		**170**	91
Manufacturing		**1,602**	1,534
Electricity, gas and water		**58**	94
Construction		**976**	820
Wholesale and retail trade		**1,721**	1,621
Accommodation, restaurants, culture and recreation		**1,170**	1,083
Transport and storage		**951**	629
Communications		**169**	190
Financial, investment and insurance		**7,805**	7,820
Property, business and personal services		**10,472**	9,766
Government, education, health and community services		**2,914**	3,043
Personal deposits		**29,011**	26,840
Total customer deposits by industry		**59,776**	56,131
Concentration by geography			
Wholesale funding			
New Zealand		**10,376**	9,814
Overseas[1]		**17,848**	18,061
Total wholesale funding by geography		**28,224**	27,875
Total funding		**88,000**	84,006
Total funding comprised:			
Customer deposits	18	**59,776**	56,131
Wholesale funding			
Due to central banks and other institutions		**1,944**	1,594
Other borrowings	18	**3,661**	3,781
Bonds and notes		**19,760**	20,157
Amounts due to related entities		**913**	519
Subordinated debt		**1,946**	1,824
Total wholesale funding		**28,224**	27,875
Total funding		**88,000**	84,006

[1] This represents the funding activities of BNZ-IF.

Note 35 Subsequent Events

The Board of the Bank has resolved that the Bank pay dividends of $945 million on its ordinary shares ("Dividends") on or around 7 December 2018. The Board of the Bank has also approved the issuance of 600 million ordinary shares to NAGNZ at a subscription price of $1.00 per share, with such issuance proposed to be effected on or around the payment of the Dividends. This will, on or around 7 December 2018, result in the number of the Bank's ordinary shares increasing from 4,475,997,499 to 5,075,997,499 and the Bank's ordinary share capital increasing by $600 million, resulting in a net payment to NAGNZ of $345 million.

In January 2018 the Bank announced that it had entered into an agreement to sell its shares in Paymark to Ingenico Group. Ingenico received all necessary regulatory approvals for the purchase in November 2018.

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Independent Auditor's Report to the Shareholder of Bank of New Zealand

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

Opinion

We have audited pages 8 to 76 of the Disclosure Statement of Bank of New Zealand (the "Bank") and the entities it controlled at 30 September 2018 or from time to time during the year (collectively the "Banking Group"), which includes the consolidated financial statements required by Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order") and the supplementary information required by Schedules 4, 7, 13 to 15 and 17 of the Order. The consolidated financial statements and supplementary information comprise:

- the balance sheet of the Banking Group as at 30 September 2018;
- the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended of the Banking Group;
- the notes to the consolidated financial statements of the Banking Group including a summary of significant accounting policies; and
- the supplementary information required by Schedules 4, 7, 13 to 15 and 17 of the Order.

In our opinion, the consolidated financial statements on pages 8 to 76 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 13 to 15 and 17 of the Order and included within notes 13, 29, 30, 31 and 34) give a true and fair view of the consolidated financial position of the Banking Group as at 30 September 2018 and its consolidated financial performance and cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

In our opinion, the supplementary information disclosed in accordance with Schedules 4, 7, 13 to 15 and 17 of the Order and included within notes 13, 29, 30, 31 and 34 fairly states, in all material respects, the matters to which it relates in accordance with those schedules.

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

Basis for opinion

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

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

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

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

Key audit matters

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

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

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Provision for Credit Impairment

Why significant

As described in Notes 12 Provision for Credit Impairment and 34 Risk Management, the provision for credit impairment is determined under application of NZ IFRS 9 Financial Instruments (NZ IFRS 9).

This was considered a key audit matter as significant judgment is involved to determine the provision for credit impairment.

Key areas of judgment included:

- the interpretation of the requirements to determine impairment under application of NZ IFRS 9, which is reflected in the Banking Group's expected credit loss model;
- the identification of exposures with a significant deterioration in credit quality;
- assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and macroeconomic factors (for example, unemployment, interest rates, gross domestic product, inflation and commercial property prices) as disclosed in Note 12; and
- the incorporation of forward-looking information reflect current or future external factors that are not appropriately captured by the expected credit loss model.

How our audit addressed the key audit matter

In assessing the provision for credit impairment we performed the following procedures:

- We assessed the modelling techniques and methodology against the requirements of NZ IFRS 9.
- We assessed the design and tested the operating effectiveness of the controls over the:
  - data used to determine the provision for credit impairment, including transactional data captured at loan origination; ongoing internal credit quality assessments; storage of data in data warehouses; and interfaces to the expected credit loss model.
  - expected credit loss model, including: model build and approval; ongoing monitoring/validation; model governance; and mathematical accuracy.
- We assessed and tested the material modelling assumptions as well as management overlays with a focus on the:
  - key modelling assumptions adopted by the Banking Group;
  - basis for and data used to determine management overlays; and
  - sensitivity of the collective provision to changes in modelling assumptions.
- We examined a sample of exposures and performed procedures to evaluate the:
  - timely identification of exposures with a significant deterioration in credit quality; and
  - expected loss calculation for exposures assessed on an individual basis.

We involved our Actuarial and IT specialists in areas that required specific expertise (for example data reliability and the expected credit loss model).

In addition, we assessed the adequacy of the disclosures in the Disclosure Statement.

Information Technology (IT) systems and controls over financial reporting

Why significant

A significant part of the Banking Group's financial reporting process is heavily reliant on IT systems with automated processes and controls over the capture, storage and extraction of information. A fundamental component of these processes and controls is ensuring appropriate user access and change management protocols exist, and are being adhered to.

These protocols are important because they ensure that access and changes to IT systems and related data are made and authorised in an appropriate manner.

As our audit sought to place a high level of reliance on IT systems and application controls over financial reporting, a high proportion of the overall audit effort was in this area.

How our audit addressed the key audit matter

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

As audit procedures related to IT systems and controls require specific expertise, we involved IT specialists.

We assessed the design and tested the operating effectiveness of the Banking Group's IT controls, including those over user access and change management as well as data reliability.

In a limited number of cases we adjusted our planned audit approach as follows:

- we extended our testing to identify whether there had been unauthorised or inappropriate access or changes made to critical IT systems and related data;
- where automated procedures were supported by IT systems with identified deficiencies, we extended our procedures to identify and test alternative controls; and
- where required, we performed a greater level of testing to validate the integrity and reliability of associated data and reporting.

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Information other than the consolidated financial statements, supplementary information and auditor's report

The directors of the Bank are responsible for the Disclosure Statement and Annual Report, which includes information other than the consolidated financial statements and auditor's report.

Our opinion on the consolidated financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements and supplementary information, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or supplementary information or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

If, based upon the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Directors' responsibilities for the consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements)

The directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the consolidated financial statements in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13 to 15 and 17 of the Order.

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

Auditor's responsibilities for the audit of the consolidated financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 33 and 34) disclosed in accordance with Clause 24 and Schedules 4, 7, 13 to 15 and 17 of the Order are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located at the External Reporting Board's website: https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/. This description forms part of our auditor's report.

Report on other legal and regulatory requirements (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the consolidated financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 33 to 34) for the year ended 30 September 2018:

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

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

Report on the review of supplementary information relating to capital adequacy and regulatory liquidity requirements

We have reviewed the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 11 of the Order as disclosed in notes 33 and 34 of the consolidated financial statements of the Banking Group for the year ended 30 September 2018.

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 33 and 34, is not in all material respects, disclosed in accordance with Schedule 11 of the Order.

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

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Basis for conclusion

We conducted our review in accordance with NZ SRE 2410 Review of Financial Statements Performed by the Independent Auditor of the Entity. Our responsibilities under this standard are further described in the Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements section of this report.

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 33 and 34 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 33 and 34.

Directors' responsibility for the supplementary information relating to capital adequacy and regulatory liquidity requirements

The directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 11 of the Order. The directors are also responsible for such internal control as the directors determine is necessary to enable the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the supplementary information relating to capital adequacy and regulatory liquidity requirements

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to capital adequacy and regulatory liquidity requirements, disclosed in Notes 33 and 34, is not, in all material respects, disclosed in accordance with Schedule 11 of the Order. As the auditor of the group, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

The engagement partner on the engagement resulting in this independent auditor's report is Brent Penrose.

Ernst + Young

Chartered Accountants

Auckland

5 December 2018

Credit Ratings

As at the date on which this Disclosure Statement is signed, the Bank has the following credit ratings applicable to its long term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

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

During the two-year period ended 30 September 2018:

- there was no change to the Bank's Fitch Australia Pty Limited ("Fitch Ratings") issuer credit ratings or S&P Global Ratings Australia Pty Limited ("Standard & Poor's") issuer credit ratings; and
- Moody's Investors Service Pty Limited ("Moody's Investors Service") revised the Bank's long term rating from Aa3 to A1, and revised the Bank's credit rating outlook from "outlook negative" to "outlook stable" on 19 June 2017.

The following is a summary of the descriptions of the major rating categories for rating agencies for the rating of long term obligations.

Standard & Poor's	Moody's Investors Service	Fitch Ratings	Description of Grade
AAA	Aaa	AAA	Ability to repay principal and interest is extremely strong. This is the highest investment category.
AA	Aa	AA	Very strong ability to repay principal and interest.
A	A	A	Strong ability to repay principal and interest although somewhat susceptible to adverse changes in financial conditions.
BBB	Baa	BBB	Adequate ability to repay principal and interest. More vulnerable to adverse changes.
BB	Ba	BB	Significant uncertainties exist which could affect the payment of principal and interest on a timely basis.
B	B	B	Greater vulnerability and therefore greater likelihood of default.
CCC	Caa	CCC	Likelihood of default considered high. Timely repayment of principal and interest is dependent on favourable financial conditions.
CC to C	Ca to C	CC to C	Highest risk of default.
D	-	RD & D	Obligations currently in default.

Credit ratings by Standard & Poor's and Fitch Ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories. Moody's Investors Service apply numeric modifiers 1, 2 and 3 to show relative standing within the major rating categories with 1 indicating the higher end of that category and 3 indicating the lower end.

Conditions of Registration

The conditions of registration imposed on Bank of New Zealand by the Reserve Bank of New Zealand pursuant to section 74 of the Reserve Bank of New Zealand Act 1989 which were applicable as at the balance date of this Disclosure Statement are as follows:

Conditions of registration that apply on and after 1 January 2018 - Bank of New Zealand

The registration of Bank of New Zealand (the "bank") as a registered bank is subject to the following conditions:

1. That:

   (a) the Total capital ratio of the banking group is not less than 8%;

   (b) the Tier 1 capital ratio of the banking group is not less than 6%;

   (c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5%;

   (d) the Total capital of the banking group is not less than $30 million;

   (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and

   (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration,

   the scalar referred to in the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015 is 1.06;

   "Total capital ratio", "Tier 1 capital ratio", "Common Equity Tier 1 capital ratio", and "Total capital" must be calculated in accordance with the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015;

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015.

   a Tier 2 capital instrument is an instrument that meets the requirements of subsection 2.16(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015.

1A. That:

   (a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')" (BS12) dated December 2007;

   (b) under its ICAAP the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015; and

   (c) the bank determines an internal capital allocation for each identified and measured "other material risk".

1B. That the banking group complies with all requirements set out in the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015.

1C. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

   (a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit to distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the bank's earnings
0% - 0.625%	0%
>0.625 - 1.25%	20%
>1.25 - 1.875%	40%
>1.875 - 2.5%	60%

   (b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

   (c) have the capital plan approved by the Reserve Bank.

   For the purposes of this condition of registration,

   "buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015.

   the scalar referred to in the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015 is 1.06

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

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

3. That the banking group's insurance business is not greater than 1% of its total consolidated assets.

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

(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.

4. That the aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

Credit rating of the bank [1]	Connected exposure limit (% of the banking group's Tier 1 capital)
AA / Aa2 and above	75
AA- / Aa3	70
A+ / A1	60
A / A2	40
A- /A3	30
BBB+ /Baa1 and below	15

[1] This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investors Service. (Fitch Ratings' scale is identical to Standard & Poor's.)

Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the banking group's Tier 1 capital.

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled "Connected exposures policy" (BS8) dated November 2015.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

6. That the bank complies with the following corporate governance requirements:

(a) the board of the bank must have at least five directors;

(b) the majority of the board members must be non-executive directors;

(c) at least half of the board members must be independent directors;

(d) an alternate director,—

 (i) for a non-executive director must be non-executive; and

 (ii) for an independent director must be independent;

(e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;

(f) the chairperson of the board of the bank must be independent; and

(g) the bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the bank).

For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:

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

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

8. That a person must not be appointed as chairperson of the board of the bank unless:

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

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

9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

(a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;

(b) the committee must have at least three members;

(c) every member of the committee must be a non-executive director of the bank;

(d) the majority of the members of the committee must be independent; and

(e) the chairperson of the committee must be independent and must not be the chairperson of the bank

For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.

11. That the bank will not, without first obtaining the written approval of the Reserve Bank, revoke the constitution of BNZ International Funding Limited or alter the constitution of BNZ International Funding Limited if such alteration would delete or amend or negate the effect of clause 2.2 of the constitution.

12. That:

(a) the business and affairs of the bank are managed by, or under the direction or supervision of, the board of the bank;

(b) the employment contract of the chief executive officer of the bank or person in an equivalent position (together "CEO") is with the bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the bank; and

(c) all staff employed by the bank shall have their remuneration determined by (or under the delegated authority of) the board or the CEO of the bank and be accountable (directly or indirectly) to the CEO of the bank.

13. That the bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the bank that are carried on by a person other than the bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the bank or of a service provider to the bank, the following outcomes:

(a) that the bank's clearing and settlement obligations due on a day can be met on that day;

(b) that the bank's financial risk positions on a day can be identified on that day;

(c) that the bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and

(d) that the bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

This condition ceases to apply in respect of an existing outsourcing arrangement on the earlier of either 1 October 2022 or when the existing outsourcing arrangement becomes compliant with condition 25, from which point in time condition 25 will apply to that outsourcing arrangement.

For the purposes of this condition of registration:

(a) the term "legal and practical ability to control and execute" is explained in the Reserve Bank of New Zealand document entitled "Outsourcing Policy" (BS11) dated January 2006.; and

(b) the term "existing outsourcing arrangement" is defined in the Reserve Bank of New Zealand document entitled "Outsourcing Policy" (BS11) dated September 2017.

14. That the banking group complies with the following quantitative requirements for liquidity-risk management:

(a) the one-week mismatch ratio of the banking group is not less than zero per cent at the end of each business day;

(b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and

(c) the one-year core funding ratio of the banking group is not less than 75 per cent at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated January 2018 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated December 2011.

15. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:

(a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;

(b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;

(c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and

(d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

16. That no more than 10% of total assets may be beneficially owned by a SPV.

For the purposes of this condition,

"total assets" means all assets of the banking group plus any assets held by any SPV that are not included in the banking group's assets:

"SPV" means a person—

(a) to whom any member of the banking group has sold, assigned, or otherwise transferred any asset;

(b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and

(c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

"covered bond" means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

17. That –

(a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:

   (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
   (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and

(b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
   (i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination;
   (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011; and
   (iii) the Reserve Bank has given the bank a notice of non-objection to the significant acquisition or business combination.

For the purposes of this condition of registration, "qualifying acquisition or business combination", "notification threshold" and "non-objection threshold" have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document "Significant Acquisitions Policy" (BS15) dated December 2011.

18. That the bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the bank can-
   (a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager –
      (i) all liabilities are frozen in full; and
      (ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;
   (b) apply a de minimis to relevant customer liability accounts;
   (c) apply a partial freeze to the customer liability account balances;
   (d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;
   (e) maintain a full freeze on liabilities not pre-positioned for open bank resolution; and
   (f) reinstate customers' access to some or all of their residual frozen funds.

   For the purposes of this condition of registration, "de minimis", "partial freeze", "customer liability account", and "frozen and unfrozen funds" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

19. That the bank has an Implementation Plan that-
   (a) is up-to-date; and
   (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS17) dated September 2013.

   For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

20. That the bank has a compendium of liabilities that-
   (a) at the product-class level lists all liabilities, indicating which are-
      (i) pre-positioned for Open Bank Resolution; and
      (ii) not pre-positioned for Open Bank Resolution;
   (b) is agreed to by the Reserve Bank; and
   (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

   For the purposes of this condition of registration, "compendium of liabilities" and "pre-positioned and non pre-positioned liabilities" have the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

21. That on an annual basis the bank tests all the component parts of its Open Bank Resolution solution that demonstrates the bank's prepositioning for Open Bank Resolution as specified in the bank's Implementation Plan.

   For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the Reserve Bank of New Zealand document "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

22. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 65%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

23. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

24. That the bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

25. That the bank must comply with the Reserve Bank of New Zealand document "Outsourcing Policy" (BS11) dated September 2017.

   In these conditions of registration,-

Conditions of Registration

"banking group" means Bank of New Zealand (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

"generally accepted accounting practice" – has the same meaning as in section 8 of the Financial Reporting Act 2013.

In these conditions of registration 22 to 24,-

"loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated January 2018:

"loan-to-valuation measurement period" means-

(a) the three calendar month period ending on the last day of March 2018; and

(b) thereafter a period of three calendar months ending on the last day of the third calendar month, the first of which ends on the last day of April 2018

Changes in Conditions of Registration

Effective 01 January 2018, changes were made to the Bank's Conditions of Registration that should have been noted in the Disclosure Statement for the period ending 31 March 2018, reflecting updates to the Reserve Bank of New Zealand's "Liquidity Policy" (BS13), and loan to value ratios applicable to residential mortgage lending "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19).

From 1 October 2018, the Bank's Conditions of Registration were updated to reflect minor changes to the Reserve Bank of New Zealand document "Liquidity Policy Annex" (BS13A) dated 1 October 2018.

Non-compliance with Conditions of Registration

In March 2018, the Bank identified that due to a data error, since 2003 it has incorrectly calculated unutilised credit limits for certain Customised Average Rate Loans ("CARLs") offered predominantly to business customers. The data error has not impacted any of the Bank's CARL customers but it has resulted in the misstatement of credit exposures, risk-weighted assets and exposures at default in relation to these CARLs, and the Bank's capital adequacy disclosures, in disclosure statements relating to prior financial reporting periods. The Bank considers the incorrect calculation and resulting misstatement of the Bank's capital adequacy disclosures in prior financial reporting periods to be a breach of Condition of Registration 1B but the Bank has not breached any of its required minimum capital adequacy ratios.

The data error has been corrected in the current financial reporting period and the capital adequacy ratios previously reported for the six months ended 31 March 2017 and the year ended 30 September 2017 have been restated, as follows:

	Consolidated			
	30/9/17		31/3/17	
	Unaudited Reported	Unaudited Restated	Unaudited Reported	Unaudited Restated
Common Equity Tier One capital ratio	10.65%	10.38%	10.55%	10.30%
Tier One capital ratio	12.14%	11.83%	12.06%	11.77%
Total qualifying capital ratio	13.36%	13.02%	13.29%	12.97%
Buffer ratio	5.36%	5.02%	5.29%	4.97%

In April 2018, the Bank identified that since April 2016 it has not applied the correct collateral values when calculating the risk-weighted assets of a small number of business lending exposures. This resulted in an overstatement of capital ratios by no more than 2 basis points in the financial reporting periods since 30 June 2016. The Bank considers the incorrect calculation and resulting misstatement of the Bank's capital adequacy disclosures to be a breach of Condition of Registration 1B, which has been corrected in the current financial reporting period. This matter did not cause the Bank to breach any of its required minimum capital adequacy ratios.

In July 2018, the Bank identified that it has not been recording certain contingent credit limits when calculating the risk-weighted assets of a small number of business lending exposures. This resulted in an overstatement of capital ratios by no more than 3 basis points in prior financial reporting periods. The Bank considers the incorrect calculation and resulting misstatement of the Bank's capital adequacy disclosures to be a breach of Condition of Registration 1B. This has been corrected in the current financial reporting period. This matter did not cause the Bank to breach any of its required minimum capital adequacy ratios.

The Bank is undertaking a comprehensive review of the data and systems it uses to calculate its regulatory capital, which may identify non-material errors in its calculation of regulatory capital and hence non-compliance with Condition of Registration 1B. Unless material errors are identified earlier, disclosure of the total impact of errors identified through the review, that would have caused the Bank to breach Condition of Registration 1B, will be made at the completion of the review.

Directors' Statement

The Directors of Bank of New Zealand state that each Director of the Bank believes, after due enquiry, that:

1. as at the date on which the Disclosure Statement is signed:
   (a) the Disclosure Statement contains all the information that is required by the Order; and
   (b) the Disclosure Statement is not false or misleading; and
2. during the year ended 30 September 2018:
   (a) the Bank has complied with its Conditions of Registration applicable during that period, except as disclosed on page 86 of this Disclosure Statement;
   (b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and
   (c) the Bank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 5th December 2018 and signed by Mr. McKay and Ms. Mentis as Directors and as responsible persons on behalf of all the other Directors.

D A McKay
Chairman

A Mentis
Managing Director and Chief Executive Officer