

Registered Bank Disclosure Statement

For the year ended 30 June 2020

The Kiwi bank logo consists of a bright green square containing the text "Kiwi bank." in white, sans-serif font. The word "Kiwi" is on the top line and "bank." is on the bottom line. The background of the entire page is a dark green color with a subtle pattern of small white dots. In the bottom right corner, there is a decorative element of diagonal white lines.

**Kiwi
bank.**

Disclosure statement

For the year ended 30 June 2020

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

In this Disclosure Statement, unless the context requires otherwise:

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

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General matters

Details of incorporation

Kiwibank (the “**Bank**”) is a company domiciled in New Zealand and was incorporated in New Zealand under the Companies Act 1993 on 4 May 2001. On 29 November 2001, the Bank was registered as a bank under the Reserve Bank of New Zealand Act 1989 and was required to comply with the conditions of registration as laid down by the Reserve Bank of New Zealand (“**RBNZ**”) from that date onwards.

Registered office

The registered office is: Kiwibank Limited, Level 9, 20 Customhouse Quay, Wellington 6011, New Zealand.

Address for service

The address for service is: Kiwibank Limited, Level 9, 20 Customhouse Quay, Wellington 6011, New Zealand.

Ultimate holding company

The ultimate holding company of Kiwibank is New Zealand Post Limited (“**NZP**”) whose address for service is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.

Voting securities and power to appoint directors

There are 737 million voting shares in the Bank. Kiwi Group Holdings Limited (“**KGHL**”) is the registered and beneficial holder of all voting shares. KGHL, NZP, NZSF Tui Investments Limited (“**NZSF**”), Accident Compensation Corporation (“**ACC**”) and the New Zealand Crown (being those ministers who hold shares in NZP, NZSF and ACC on behalf of the New Zealand Crown) are the only holders of a direct or indirect qualifying interest in the voting shares of the Bank.

KGHL has the ability to directly appoint the Board of Directors of Kiwibank (the “**Board**”). NZP, as an immediate parent of KGHL and the ultimate holding company of the Bank, has the ability to indirectly appoint directors to the Board. NZSF and ACC, as immediate parents of KGHL, also have the ability to indirectly appoint to the Board. No appointment of any director, chief executive, or executive, who reports or is accountable directly to the chief executive, shall be made in respect of the Bank unless:

1. the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
2. the RBNZ has advised that it has no objection to that appointment.

Other material matters

The Board of Directors of Kiwibank (the “**Board**”) are of the opinion that there are no matters relating to the business or affairs of Kiwibank 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 Kiwibank or any member of the Banking Group is the issuer.

Pending proceedings or arbitration

The Board is not aware of any pending legal proceedings or arbitration concerning Kiwibank or any member of the Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on Kiwibank or the Banking Group.

General matters continued

Directorate

INDEPENDENT NON-EXECUTIVE DIRECTOR, CHAIR

Jonathan Peter Hartley (appointed 28 November 2019)

Qualifications: BA (Hons), FCA, ACA, FAICD

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: Yes

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of Chorus Limited, Chorus NZ Limited, Timberlands Limited.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Michael Charles John O'Donnell

Qualifications: BA (Hons)

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: No

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of MOD Associates Limited, Serato Audio Research Limited, Timely Limited, Tourism New Zealand, Kiwi Investment Management Limited, Kiwi Wealth Limited, Kiwi Wealth Investments General Partner Limited, Portfolio Custodial Nominees Limited, Radio New Zealand Limited, RealEstate.co.nz Limited.

Kevin Mark Malloy

Qualifications: Dip Advertising & Marketing

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: Yes

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of Television New Zealand Limited, KM54 Limited, NZ Cricket Board.

Alistair Bruce Ryan

Qualifications: MCom, FCA

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: Yes (Chair)

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of Barramundi Limited, Metlifecare Limited, Metlifecare LTIP Trustee Limited, Kingfish Limited, Marlin Global Limited, Dorsal Digital Limited

Ian Cameron Blair

Primary occupation: Managing Director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: No

Risk, Credit and Compliance Committee member: Yes (Chair)

External Directorships: Director of each of Sapience Limited, Opus, Opus Fiji, WSP New Zealand Limited.

General matters continued

Directorate continued

NON-EXECUTIVE DIRECTORS

Carol Anne Campbell

Qualifications: BCom, CA

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: Yes

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of New Zealand Post Limited, Hick Bros Holdings Limited, AlphaXRT Limited, Kingfish Limited, Marlin Global Limited, Barramundi Limited, Key Assets NZ Limited, Fostering First New Zealand Limited, Michelle Alexander Trustees Limited, TBAG Trustees Me Limited, Nica Trustees KA Limited, MH2 Trustees Limited, Farrimond Trustees Limited, Moore Nominees Limited, Hick Bros Earthmoving Limited, Hick Earthmoving Contractors Limited, Hick Bros Earthmoving Contractors Limited, Hick Bros Civil Construction Limited, Hick Bros Heavy Haulage Limited, Shortland Trustees (Mawhiti 2010) Limited, Alilou Trustees Limited, TBAG Trustees (Glanfield) Limited, Asset Plus Limited, Asset Plus Investments Limited, Earnslaw Lodge Limited, Sonoma Limited, Meridian Properties Limited, Hick Bros Infrastructure Limited, Cloudbreak Trustees Limited, Seahorse Trust Company Limited, NZME Limited, T&G Global Limited, Cordbank Limited, Nica Consulting Limited, Bankside Chambers Limited, T&G Insurance Limited, Chubb Insurance New Zealand Limited, Woodford Properties 2018 Limited, Merinous Management Company Limited, Lakes Marina Projects Limited.

Scott John Pickering

Qualifications: Associate Certified Insurance Professional, Certificate of Insurance (Non-Life)

Primary occupation: Chief Executive Officer, ACC

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: No

Risk, Credit and Compliance Committee member: Yes

External Directorships: Director of each of Chubb Insurance New Zealand Limited, Chubb Holdings Australia PTY Ltd, Chubb Insurance Australia Limited.

John Gilbert Sproat (appointed 20 February 2020)

Qualifications: BA, LLB (Hons)

Primary occupation: Company director

Country of residence: New Zealand

Finance, Audit and Disclosure Committee member: No

Risk, Credit and Compliance Committee member: No

External Directorships: Director of each of New Zealand Post Limited, Rakau Properties Limited, Rakau Properties (No. 2) Limited, Kai Waho Limited.

CHANGES IN BOARD OF DIRECTORS

David Walsh resigned as a director on 30 September 2019.

Susan Carrel Macken resigned as a director and Chair on 28 November 2019.

Jonathan Peter Hartley was appointed as a director and Chair on 28 November 2019.

John Gilbert Sproat was appointed as a director on 20 February 2020.

General matters continued

Directorate continued

FINANCE, AUDIT AND DISCLOSURE COMMITTEE

The charter of the Finance, Audit and Disclosure Committee provides that the membership of the Committee must include a majority of Independent Directors, a member of the Risk, Credit and Compliance Committee, and at least one member with material accounting experience. The Committee is made up of four directors (three independent non-executive directors and one non-executive director).

EXECUTIVE DIRECTORS

There are no executive directors of the Bank.

COMMUNICATIONS WITH DIRECTORS

Communications addressed to the directors and responsible persons may be sent to the Bank's address for service.

POLICY FOR AVOIDING AND DEALING WITH CONFLICTS OF INTEREST

The policy and current practice of the Board is that conflicts of interest which may arise from the personal, professional or business interests of the directors, or any of them, must be disclosed to the Board. Directors are not entitled to vote on any matter in which they have an interest, unless Kiwibank's shareholders have agreed by ordinary resolution (or written notice signed by a majority of shareholders) to waive this requirement or unless the matter is one in respect of which the directors are required to provide a certificate under the Companies Act 1993. However, directors can be counted in the quorum for any part of a Board meeting in respect of which they have a conflict.

The Companies Act 1993 requires each director's interest to be entered in the interests register and disclosed to the Board:

- a) 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
- b) 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 Kiwibank which either has been entered into on terms other than those which would, in the ordinary course of business of Kiwibank, 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.

AUDITOR

The auditor whose report is referred to in this Disclosure Statement is Michele Embling assisted by PricewaterhouseCoopers, acting as agent on behalf of the Office of the Auditor-General. Her address for service is: PricewaterhouseCoopers, PwC Centre, 10 Waterloo Quay, Wellington 6011, New Zealand.

Credit ratings

The Bank has the following credit ratings applicable to its long-term senior unsecured obligations payable in New Zealand dollars at the date the directors signed this Disclosure Statement.

Rating agency	Current credit rating	Rating outlook
S&P Global Ratings Australia Pty Limited (“S&P”)	A	Outlook Stable
Moody’s Investors Service (“Moody’s”)	A1	Outlook Stable
Fitch Ratings (“Fitch”)	AA	Outlook Stable

RECENT RATING ACTIONS AND CHANGES IN CREDIT RATINGS

The most recent Rating Actions and any changes in the credit ratings or rating outlooks shown above that were made in the two years prior to signing date are outlined below:

S&P

- On 6 May 2020, S&P affirmed Kiwibank’s credit rating at A and changed the rating outlook from positive to stable.
- On 29 October 2018, S&P affirmed Kiwibank’s credit rating at A and changed the outlook from stable to positive.

Moody’s

- On 25 November 2019, Moody’s affirmed Kiwibank’s credit rating at A1 with a stable outlook.

Fitch

- On 18 May 2020, Fitch affirmed Kiwibank’s credit rating at AA with a stable outlook for senior unsecured debt obligations payable in New Zealand dollars, and a credit rating of AA- with a positive outlook for senior unsecured debt obligations payable in other currencies.
- On 30 January 2020, Fitch affirmed Kiwibank’s credit rating at AA with a stable outlook for senior unsecured debt obligations payable in New Zealand dollars. Fitch also affirmed Kiwibank’s credit rating at AA- for senior unsecured debt obligations payable in other currencies and revised the outlook from stable to positive.

The following table describes the steps in the applicable rating scales for each rating agency:

	S&P	Moody’s	Fitch
Highest credit quality – ability to repay debt obligations is extremely strong	AAA	Aaa	AAA
High quality, low credit risk – ability to repay debt obligations is very strong	AA	Aa	AA
High quality – ability to repay is strong although may be susceptible to adverse changes in circumstances or in economic conditions	A	A	A
Low credit risk – satisfactory ability to repay debt obligations though changes in circumstances or in economic conditions are likely to impair this capacity	BBB	Baa	BBB
Ability to repay debt obligations is only adequate and likely to be affected by adverse economic change which might affect timeliness of repayment	BB	Ba	BB
Risk of default due to greater vulnerability	B	B	B
Significant risk of default. Repayment of debt obligations requires favourable financial conditions	CCC	Caa	CCC
Poor protection, highest risk of default	CC to C	Ca to C	CC to C
Obligations currently in default	D	-	RD to D

Credit ratings between AA and CCC by S&P and Fitch may be modified by the addition of a plus or minus sign (signalling higher and lower ends of the scale respectively). Moody’s applies numeric modifiers 1, 2 and 3 to each generic rating classification between Aa and B with a 1 indicating a higher rating and a 3 indicating a lower rating within that generic rating category.

Guarantees

As at the date the Board approved this Disclosure Statement, payment obligations of Kiwibank in relation to certain debt securities issued by Kiwibank have the benefit of a guarantee by Kiwi Covered Bond Trustee Limited (the “**Covered Bond Guarantee**”). Also, the payment obligations of Kiwibank owed as at 28 February 2017 and still outstanding have the benefit of a deed poll guarantee by NZP (the “**NZP Guarantee**”).

On 31 October 2016, NZP gave notice of the termination of the NZP Guarantee (with an effective date of withdrawal of 28 February 2017). This termination did not affect any payment obligations of Kiwibank that were already guaranteed at the time the guarantee was terminated. A summary of the details of each guarantee are set out below.

COVERED BOND GUARANTEE

Certain debt securities (“**Covered Bonds**”) issued by the Bank are guaranteed by Kiwi Covered Bond Trustee Limited (the “**Covered Bond Guarantor**”), solely in its capacity as Trustee of Kiwi Covered Bond Trust. No material conditions apply to the Covered Bond Guarantee other than non-performance by Kiwibank. There are no material legislative or regulatory restrictions in New Zealand which would have the effect of subordinating the claims under the guarantee of any creditors of the Banking Group 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.

The Covered Bond Guarantor’s guarantee is limited to the payment of interest on and the principal of Covered Bonds, and such guarantee is secured over a pool of assets. There are no other limits on the amount of obligations guaranteed. The carrying value and approximate fair value of the Kiwi Covered Bond Trust pool at 30 June 2020 is \$316m (30 June 2019: \$316m).

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 applicable credit rating. The Covered Bonds have been assigned a long-term rating of Aaa and AAA by Moody’s and Fitch respectively.

NZP GUARANTEE

NZP continues to support Kiwibank as a registered bank through the NZP Guarantee to the extent of guaranteed payment obligations that existed as at 28 February 2017. No material conditions apply to the NZP Guarantee other than non-performance by Kiwibank.

The following is a summary of the main features of the NZP Guarantee effective for payment obligations that existed as at 28 February 2017:

- i) The address for service of NZP is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.
- ii) NZP is not a member of the Banking Group (as that term is defined in the Order).
- iii) The NZP Guarantee is an unsecured guarantee of all the payment obligations (excluding any payment obligations, the terms of which expressly provide in writing that they do not have the benefit of the NZP Guarantee) of Kiwibank owing as at 28 February 2017 and still outstanding. The NZP Guarantee has no expiry date in relation to the payment obligations that continue to be guaranteed.
- iv) There are no material legislative or regulatory restrictions in New Zealand which would have the effect of subordinating the claims under the NZP Guarantee of any of the creditors of Kiwibank on the assets of NZP, to other claims on NZP, in a winding up of NZP. The net tangible assets of NZP were \$607m as calculated from NZP’s most recent publicly available audited financial statements for the year ended 30 June 2019 (there were no modifications in the audit report accompanying the NZP Annual Report). The net tangible assets are also disclosed in the Directors’ Report in the NZ Post Group Finance Limited Annual Report for the year ended 30 June 2019.

NZP has a credit rating applicable to its long-term unsecured obligations payable in New Zealand, in New Zealand dollars, from S&P of A with a stable outlook. On 19 December 2019, S&P lowered NZP’s credit rating to A with a stable outlook from A+ with a negative outlook. On 1 October 2019, S&P affirmed NZP’s credit rating at A+ and lowered the outlook from stable to negative. There have been no other changes in NZP’s credit rating in the two years prior to signing date.

See the previous page for an explanation of S&P’s credit rating scale.

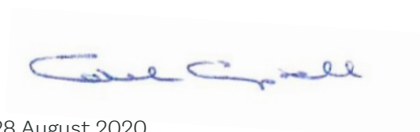
Directors' statement

The directors of Kiwibank state that each director believes, after due enquiry, that:

1. As at the date on which the Disclosure Statement is signed:
 - i) the Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended); and
 - ii) the Disclosure Statement is not false or misleading.
2. During the year ended 30 June 2020:
 - i) Kiwibank has complied with the conditions of registration applicable during the period except as noted on page 123;
 - ii) credit exposures to connected persons were not contrary to the interests of the Banking Group; and
 - iii) Kiwibank 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.

With agreement of the shareholder, the Bank has taken advantage of the concessions available to it under section 211 (3) of the Companies Act 1993.

Signed by Jonathan Peter Hartley and Carol Anne Campbell as directors and responsible persons on behalf of all the directors listed in the Directorate of this Disclosure Statement.



28 August 2020

Historical summary of financial statements

Audited	Year ended	Year ended	Year ended	Year ended	Year ended
Dollars in millions	30/06/20	30/06/19	30/06/18	30/06/17	30/06/16
Financial performance					
Interest income	894	933	879	831	898
Interest expense	(439)	(488)	(468)	(463)	(525)
Net gains on financial instruments	13	3	9	8	3
Net fee income	85	90	119	118	101
Operating expenses	(428)	(375)	(373)	(339)	(301)
Credit impairment (losses)/reversals	(51)	(12)	(1)	6	(11)
Other impairment losses	-	-	(11)	(90)	-
Profit before taxation	74	151	154	71	165
Income tax expense	(17)	(43)	(39)	(18)	(41)
Net profit after taxation	57	108	115	53	124
Net profit after taxation attributable to non-controlling interests	-	-	-	-	-
Dividends paid to non-controlling interest	-	-	-	(1)	-
Dividends paid on ordinary shares	(17)	(25)	-	(5)	(29)
Distributions to holders of perpetual capital	(11)	(11)	(11)	(12)	(11)
Dividends paid to holders of perpetual shares	-	-	-	-	-

Audited	As at	As at	As at	As at	As at
Dollars in millions	30/06/20	30/06/19	30/06/18	30/06/17	30/06/16
Balance sheet					
Total assets	25,510	22,734	20,715	20,616	19,357
Of which individually impaired assets	2	5	10	12	15
Total liabilities	23,940	21,185	19,228	19,236	18,228
Equity attributable to owners of parent	1,570	1,549	1,487	1,380	1,129
Non-controlling interest	-	-	-	-	-

Financial statements

Income statement

For the year ended 30 June 2020

Dollars in millions	Note	Year ended 30/06/20	Year ended 30/06/19
Interest income	3	894	933
Interest expense	3	(439)	(488)
Net interest income		455	445
Net gains on financial instruments	4	13	3
Gross fee and other income	5	181	185
Direct fee expenses	5	(96)	(95)
Net fee and other income	5	85	90
Total operating income		553	538
Operating expenses	6	(428)	(375)
Profit before credit impairment and taxation		125	163
Credit impairment losses	9	(51)	(12)
Profit before taxation		74	151
Income tax expense	7	(17)	(43)
Profit after taxation		57	108

Statement of comprehensive income

For the year ended 30 June 2020

Dollars in millions	Note	Year ended 30/06/20	Year ended 30/06/19
Profit after taxation		57	108
Other comprehensive income			
Net gains/(losses) from changes in reserves that may subsequently be reclassified to profit or loss:			
- Fair value reserve (net of tax)	29	13	6
- Cash flow hedge reserve (net of tax)	29	(22)	(12)
Other comprehensive income for the year		(9)	(6)
Total comprehensive income for the year		48	102

From 1 July 2019, the Banking Group has applied NZ IFRS 16 in the preparation of the income statement and statement of comprehensive income. See note 39 for more details of the related changes in accounting policies and impact of adoption.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these financial statements.

Financial statements continued

Statement of changes in equity

For the year ended 30 June 2020

Dollars in millions	Note	Fully paid ordinary shares	Retained earnings	Fair value reserve	Cash flow hedge reserve	Total shareholder's equity
Balance at 30 June 2018		737	755	5	(10)	1,487
Balance adjusted for adoption of NZ IFRS 9 and NZ IFRS 15		-	(4)	-	-	(4)
Opening balance at 1 July 2018		737	751	5	(10)	1,483
Year ended 30 June 2019						
Profit for the year		-	108	-	-	108
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		-	-	6	-	6
Cash flow hedges (net of tax)		-	-	-	(12)	(12)
Total other comprehensive income		-	-	6	(12)	(6)
Total comprehensive income		-	108	6	(12)	102
Transactions with owners						
Dividends paid on ordinary shares	29	-	(25)	-	-	(25)
Distributions to holder of perpetual capital	29	-	(11)	-	-	(11)
Balance at 30 June 2019		737	823	11	(22)	1,549
Balance adjusted for adoption of NZ IFRS 16	39	-	1	-	-	1
Opening balance as at 1 July 2019		737	824	11	(22)	1,550
Year ended 30 June 2020						
Profit for the year		-	57	-	-	57
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		-	-	13	-	13
Cash flow hedges (net of tax)		-	-	-	(22)	(22)
Total other comprehensive income		-	-	13	(22)	(9)
Total comprehensive income		-	57	13	(22)	48
Transactions with owners						
Dividends paid on ordinary shares	29	-	(17)	-	-	(17)
Distributions to holder of perpetual capital	29	-	(11)	-	-	(11)
Balance at 30 June 2020		737	853	24	(44)	1,570

From 1 July 2019, the Banking Group has applied NZ IFRS 16 in the preparation of the statement of changes in equity. See note 39 for more details of the related changes in accounting policies and impact of adoption.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these financial statements.

Financial statements continued

Balance sheet

As at 30 June 2020

Dollars in millions	Note	30/06/20	30/06/19
Assets			
Cash and cash equivalents	13	492	421
Due from related parties	30	77	85
Due from other financial institutions	14	105	71
Investment securities	15	1,895	1,176
Derivative financial instruments	16	434	358
Loans and advances	8	22,222	20,443
Property, plant and equipment		49	51
Right-of-use asset	28	95	-
Deferred taxation	7	43	21
Intangible assets	25	60	74
Other assets	26	38	34
Total assets		25,510	22,734
<i>Total interest-earning and discount-bearing assets</i>		24,711	22,081
Liabilities			
Due to other financial institutions	17	317	126
Due to related parties	30	7	9
Deposits and other borrowings	18	20,597	18,240
Derivative financial instruments	16	400	343
Debt securities issued	19	2,229	2,078
Current tax liability		23	7
Lease liabilities	28	97	-
Contract liabilities	5	10	27
Other liabilities	27	110	102
Subordinated debt	20	150	253
Total liabilities		23,940	21,185
<i>Total interest-earning and discount-bearing liabilities</i>		19,930	18,325
Shareholder's equity			
Share capital	29	737	737
Reserves	29	833	812
Total shareholder's equity		1,570	1,549
Total liabilities and shareholder's equity		25,510	22,734

From 1 July 2019, the Banking Group has applied NZ IFRS 16 in the preparation of the balance sheet. See note 39 for more details of the related changes in accounting policies and impact of adoption.

The Board of Directors of Kiwibank Limited authorised these financial statements for issue on 28 August 2020.



Jonathan Peter Hartley



Carol Anne Campbell

The notes to the financial statements form an integral part of, and should be read in conjunction with, these financial statements.

Financial statements continued

Cash flow statement

For the year ended 30 June 2020

Dollars in millions	Note	Year ended 30/06/20	Year ended 30/06/19
Cash flows from operating activities			
Interest received		932	967
Interest paid		(454)	(462)
Fees and other income received		164	185
Direct fee expenses paid		(96)	(95)
Operating expenses paid		(375)	(340)
Taxes paid		(21)	(29)
Net cash flows from operating activities before changes in operating assets and liabilities		150	226
Net changes in operating assets and liabilities			
Investment securities		(696)	53
Loans and advances		(1,853)	(2,137)
Balances due from related parties		6	3
Balances due from other financial institutions		(34)	61
Deposits and other borrowings		2,377	2,047
Balances due to other financial institutions		191	(2)
Contract liabilities		-	21
Net cash flows from operating activities		141	272
Cash flows from investing activities			
Purchase of property, plant and equipment		(10)	(18)
Purchase of intangible assets		(12)	(21)
Net cash flows from investing activities		(22)	(39)
Cash flows from financing activities			
Issue of debt securities	19	1,627	1,102
Redemption of debt securities	19	(1,537)	(1,325)
Payment of principal portion of lease liability	28	(12)	-
Repayment of subordinated debt	20	(100)	-
Dividends paid on ordinary shares		(17)	(25)
Distributions to holders of perpetual capital		(11)	(11)
Net cash flows from financing activities		(50)	(259)
Increase/(decrease) in cash and cash equivalents		69	(26)
Cash and cash equivalents at beginning of the year		421	447
Effect of exchange translation adjustments		2	-
Cash and cash equivalents at end of the year	13	492	421

The notes to the financial statements form an integral part of, and should be read in conjunction with, these financial statements.

Financial statements continued

Cash flow statement continued

For the year ended 30 June 2020

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Reconciliation of profit after taxation to net cash flows from operating activities		
Profit after taxation	57	108
Non-cash movements and non-operating activities		
Unrealised fair value adjustments	(9)	(5)
Depreciation	26	12
Amortisation	26	25
Decrease in deferred expenditure	38	36
Movement in contract liabilities	(17)	-
Movement in provision for credit impairment	46	4
Lending losses written off	5	8
Intangible work in progress written off or impaired	6	-
Movement in interest	(16)	26
Movement in current and deferred tax	(4)	12
Other non-cash movements	(8)	-
Decrease/(increase) in operating assets		
Investment securities	(696)	53
Loans and advances	(1,853)	(2,137)
Balances due from other financial institutions	(34)	61
(Decrease)/increase in operating liabilities		
Deposits and other borrowing	2,377	2,047
Balances with related parties	6	3
Balances due to other financial institutions	191	(2)
Contract liabilities	-	21
Net cash flows from operating activities	141	272

From 1 July 2019, the presentation of debt securities has been adjusted to reflect issue of debt securities and redemption of debt securities as separate line items rather than as a net movement. Comparatives have been restated for consistency resulting in a \$56m increase in net cash flows from operating activities and an offsetting \$56m decrease in net cash flows from financing activities.

From 1 July 2019, the Banking Group has applied NZ IFRS 16 in the preparation of the cash flow statement. See note 39 for more details of the related changes in accounting policies and impact of adoption. The comparative prior period amounts have been reclassified to align with the categories used in the current period's presentation.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these financial statements.

Notes to the financial statements

1. Corporate information

These consolidated financial statements are presented for the “**Banking Group**”, which consists of Kiwibank Limited (“**Kiwibank**” or the “**Bank**”) and its subsidiaries. Kiwibank is a for-profit entity incorporated and domiciled in New Zealand under the Companies Act 1993 and is registered as a bank under the Reserve Bank of New Zealand Act 1989. The principal activity of the Banking Group is the provision of banking products and services to individuals and small to medium-sized businesses.

Kiwibank’s immediate parent company is Kiwi Group Holdings Limited (“**KGHL**”). KGHL is owned by New Zealand Post Limited (“**NZP**”) (53%), NZSF Tui Investments Limited (“**NZSF**”) (25%) and Accident Compensation Corporation (“**ACC**”) (22%). The ultimate holding company of Kiwibank is NZP whose address for service is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand. The ultimate shareholder of Kiwibank is the New Zealand Crown (the “**Crown**”).

These financial statements for the year ended 30 June 2020 have been approved for issue by the Board of Directors on 28 August 2020.

2. Basis of preparation and general accounting policies

2.1 Basis of accounting

These financial statements are general purpose financial statements prepared in accordance with Generally Accepted Accounting Practice in New Zealand. They comply with New Zealand Equivalents to International Financial Reporting Standards (“**NZ IFRS**”) and other applicable Financial Reporting Standards, as appropriate for for-profit entities, the Financial Markets Conduct Act 2013 and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the “**Order**”). These financial statements also comply with International Financial Reporting Standards (“**IFRS**”) as issued by the International Accounting Standards Board (“**IASB**”).

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

Measurement base

These financial statements are based on the general principles of historic cost accounting, modified by the application of fair value measurements for financial instruments held at fair value through other comprehensive income, financial instruments held at fair value through profit or loss and derivatives used for hedging. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and otherwise carried at amortised cost, are adjusted to record changes in fair value attributable to the risks that are being hedged.

Accounting period and comparative amounts

These audited financial statements are for the year ended 30 June 2020. Comparative amounts are from the audited financial statements for the year ended 30 June 2019. Certain amounts in the comparative information have been reclassified or amended to ensure consistency with the current period’s presentation. Changes are disclosed within impacted notes where relevant.

2.2 Critical accounting judgements, estimates and assumptions

The preparation of these financial statements in accordance with NZ IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. Although Kiwibank has internal control systems in place to ensure that estimates can be reliably measured, actual amounts may differ from those estimates. It is not anticipated that such differences would be material.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised and any future years affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Note 5 Contract liabilities and the timing of income recognition
- Note 9 Credit impairment provisions and measurement of expected credit losses
- Note 22 Fair value estimation
- Note 25 Intangible assets and impairment testing
- Note 28 Determining the terms of lease contracts and calculating Incremental Borrowing Rates (“**IBR**”)
- Note 30 Securitisation and the consolidation of special purpose vehicles (“**SPV**”)

In addition, the critical accounting estimates applied in relation to impairment testing and the assessment of the value of the Banking Group’s non-financial assets is described below.

Impacts of COVID-19 pandemic on judgements and estimates

The specific impact of the COVID-19 pandemic on impairment testing has been described below. Where relevant, the other specific impacts and additional areas of judgement applied due to the impact of the COVID-19 pandemic have been disclosed within the notes above and in the following notes:

- Note 29 Equity
- Note 33 Risk management

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.2 Critical accounting judgements, estimates and assumptions continued



Impairment testing of non-financial assets

The Banking Group's non-financial assets, including intangible assets, are assessed for indicators of impairment on at least an annual basis and whenever events or changes in circumstances indicate that the carrying amount of the assets may exceed their recoverable amount. In addition, intangible assets that are not yet available for use are tested annually for impairment irrespective of whether there is any indication of impairment. Where the asset's carrying amount is determined to be greater than the recoverable amount, the carrying amount is written down and an impairment loss is recognised in the income statement. Impairment testing involves a significant amount of estimation. Impairment testing involves assessing the recoverable amount of the Banking Group's assets by calculating the higher of the assets value in use or fair value less costs of disposal.

The recoverable amount calculated under the value in use method includes cash flow projections that necessarily take into account changes in the market in which a business operates including the level of growth, competitive activity and the impacts of regulatory change. Determining both the cash flows and the risk adjusted discount rate appropriate to the operating unit requires the exercise of judgement. The estimation of cash flows is sensitive to the periods for which detailed forecasts are available and to assumptions regarding long-term sustainable cash flows.

The recoverable amount calculated under the fair value less cost of disposal method involves estimating the price a willing buyer would be prepared to pay to a willing seller less direct costs. The fair value less cost of disposal is estimated using a variety of methods including discounted cashflows, earnings multiples and net tangible asset multiples. In addition to estimating cash flows, the risk adjusted discount rate, and future maintainable earnings, this approach also uses observable market inputs for trading multiples of similar entities. All of these inputs require judgement and have an impact on the estimated fair value less cost of disposal.

The assessment of impairment requires judgement to be applied and consideration of a number of factors including but not limited to: changes in business strategy, technology, regulations, and customer preferences or requirements.

Annual impairment testing

The deterioration in economic conditions as a result of the COVID-19 pandemic lockdowns and border closures, and the consequential impact on Kiwibank are potential indicators of impairment. In addition to this the Shareholder of Kiwibank commissioned a valuation of the Banking Group for another purpose. Despite this valuation being prepared on a different basis, it did provide a further indication of the need to carry out impairment testing. As a result of these factors, impairment testing was carried out as part of the process of preparing these financial statements. The recoverable amount of the Banking Group's cash generating unit ("**CGU**") was estimated using the fair value less cost of disposal ("**FVLCOD**") expected to be realised in the sale of the Bank. The Bank considered the FVLCOD under a number of accepted methodologies and determined the capitalisation of net tangible assets ("**NTA**") and capitalisation of earnings to be most appropriate. The key inputs and assumptions in determining the recoverable amounts under these methods were the Banking Group's reported net tangible assets at 30 June 2020, future expectations of the CGU's maintainable earnings and observable market trading multiples seen in recent transactions of similar entities (referencing industry, geography, transaction size and control premium/discounts).

Under the capitalisation of NTA approach, multiples of 1.0x to 1.7x were observed, providing a valuation range of \$1,509m to \$2,354m. At a midpoint of 1.35x NTA (used as a point estimate within the range), the recoverable amount of \$1,932m exceeds the carrying amount of the Banking Group's net assets by \$362m.

Under the capitalisation of earnings approach, multiples of 11.0x to 13.0x future maintainable earnings were observed providing a valuation range of \$1,512m to \$1,732m. At a midpoint of 12.0x future maintainable earnings (used as a point estimate within the range), the recoverable amount of \$1,622m exceeds the carrying amount of the Banking Group's net assets by \$52m.

While an assessed value at 1.0x NTA or 11.1x earnings would result in an impairment, this is not considered a reasonably possible outcome that could arise from a change in the valuation assumptions utilised.

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of Kiwibank and its subsidiaries for the year ended 30 June 2020. Subsidiaries are entities that are controlled by the Banking Group. Control is achieved when the Banking Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically the Banking Group controls an investee if, and only if, the Banking Group has:

- power over the investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

When the Banking Group has less than a majority of the voting or similar rights of an investee, the Banking Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangements with other vote holders of the investee;
- rights arising from other contractual arrangements; and
- the banking group's voting rights and potential voting rights.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.3 Basis of consolidation continued

Structured entities are entities that are designed so that their activities are not governed by way of voting rights. In assessing whether the Banking Group has power over such entities in which it has an interest, the Banking Group also considers factors such as:

- the purpose and design of the entity;
- its practical ability to direct the relevant activities of the entity;
- the nature of the relationship with the entity; and
- the size of its exposure to the variability of returns of the entity.

The Banking Group reassesses whether it controls an investee if facts and circumstances indicate that there have been changes to one or more of the three elements of control.

Consolidation of a subsidiary begins when the Banking Group obtains control over the subsidiary and ceases when the Banking Group loses control of the subsidiary. On the date of acquisition of a subsidiary, identifiable assets and liabilities acquired are initially measured at fair value. The excess of the cost of acquisition over the fair value of the Banking Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Banking Group's share of the net assets acquired, the difference is recognised directly in the income statement.

Subsequent to initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired is, from the date of acquisition, allocated to each of the Banking Group's cash-generating units that are expected to benefit from the acquisition, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

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

All intra-group balances, transactions, income or expenses are fully eliminated on consolidation. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Banking Group's accounting policies.

2.4 Associates and joint arrangements

An associate is an entity over which the Banking Group has a significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over these policies.

A joint arrangement, where the Banking Group and one or more other parties have joint control, is either a joint operation or a joint venture. In a joint operation, the Banking Group and other party or parties with joint control have rights to the assets and obligations for the liabilities of the arrangement resulting in each party recognising its relative share of the joint operation's assets, liabilities, revenues and expenses. In a joint venture, the Banking Group and other party or parties with joint control have rights to the net assets of the arrangement and each party uses the equity method.

2.5 New Accounting Standards and Interpretations

The Banking Group has applied, for the first time, the following new standard and amendments to existing standards in the current period:

- NZ IFRS 16: *Leases*
- Interest Rate Benchmark Reform – *Amendments to NZ IFRS 9, NZ IAS 39 and NZ IFRS 7*

NZ IFRS 16: *Leases* was adopted without restatement of comparative amounts. Changes in accounting policies are described in note 39 including a description of the nature and effect of the changes made in the entity's accounting policies due to the adoption of the above standard and the financial impact of adoption.

Interest Rate Benchmark Reform

Background

Interest rate benchmarks such as interbank offered rates (IBORs) play an important role in financial markets. Market developments have undermined confidence in the reliability and robustness of some interest rate benchmarks resulting in market-led working groups in several jurisdictions reviewing major interest rate benchmarks. In some jurisdictions, there has been clear progress towards the replacement of interest rate benchmarks with the alternative, nearly risk-free interest rates that are based on transaction data. These reforms have led to uncertainty about the long-term viability of some interest rate benchmarks beyond 1 January 2022.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.5 New Accounting Standards and Interpretations continued

Accounting amendments in relation to the impact of Interest Rate Benchmark Reform

In November 2019, the External Reporting Board (“XRB”) issued the standard Interest Rate Benchmark Reform – *amendments to NZ IFRS 9 Financial Instruments, NZ IAS 39 Financial Instruments: Recognition and Measurement and NZ IFRS 7 Financial Instruments: Disclosures* (Interest Rate Benchmark Reform), effective for periods beginning on or after 1 January 2020. Interest Rate Benchmark Reform was early adopted by the Banking Group from 1 July 2019. These amendments modified specific hedge accounting requirements to provide relief from the potential uncertainty caused by the Interest Rate Benchmark Reform. The Banking Group is able to apply certain exemptions to the standard hedging requirements in respect of hedge relationships that are impacted by a market-wide interest rate benchmark. The amendments did not have a significant impact on the Banking Group on adoption.

The Interest Rate Benchmark Reform amendments are part of phase 1 of the two-phase International Accounting Standard Board reform project. Phase 1 considers relief to hedge accounting in the period before reform. The International Accounting Standards Board has issued an exposure draft covering Phase 2 of the reform project which focuses on the financial reporting issues that may arise once the existing rate is replaced with an alternative rate.

The Banking Group continues to monitor the developments and expected impacts of the Interest Rate Benchmark Reform. The Banking Group’s hedging activities expose it to CHF LIBOR which is subject to cessation.

The table below details the carrying value of the Banking Group’s IBOR exposures designated in hedge accounting relationships maturing after 31 December 2021, which will be impacted by the Interest Rate Benchmark Reform. The extent of the risk exposure also reflects the notional value of the associated hedging instruments.

Dollars in millions	30/06/20 Notional hedged exposure
CHF LIBOR	150

In the current year, the Banking Group also applied other amendments to Accounting Standards and Interpretations that are effective for an annual period that begins on or after 1 July 2019. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

No other new standards, amendments or interpretations to existing standards that are not yet effective have been early adopted by the Banking Group in these financial statements. The directors expect to adopt the following standards in the period within which they become mandatory.

At the date of authorisation, the following new standards, amendments or interpretations to existing standards had been issued:

Standard	Effective for annual reporting periods beginning on or after:
NZ IFRS 17: <i>Insurance Contracts</i>	1 January 2023

NZ IFRS 17: Insurance Contracts

The final version of NZ IFRS 17: *Insurance Contracts* was issued in August 2017 and is not effective for the Banking Group until 1 July 2023. On 20 August 2020, the XRB issued an amendment to NZ IFRS 17 that deferred the effective date to reporting periods beginning on or after 1 January 2023. NZ IFRS 17 establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts.

The Banking Group does not currently issue insurance or reinsurance contracts nor does it hold reinsurance contracts or issue investment contracts with discretionary participation features. Therefore, NZ IFRS 17 is not expected to have a material impact on the Banking Group.

2.6 Financial instruments

Recognition

The Banking Group initially recognises loans and advances, deposits and other borrowings, certain debt securities issued and subordinated debt on the date on which they were originated. All other financial instruments are recognised on trade-date – the date on which the Banking Group becomes a party to the contractual provisions of the instrument.

Financial instruments are measured initially at fair value, plus, for an item not at fair value through profit or loss, transaction costs directly attributable to its acquisition or issue.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Derecognition

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

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

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

The Banking Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Classification

Financial assets

On initial recognition, a financial asset is classified as measured at: amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL").

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI").

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

On initial recognition of an equity investment that is not held for trading, the Banking Group may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Banking Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or as at FVOCI or as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Banking Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Banking Group's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed;
- how managers of the business are compensated (e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected); and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Banking Group's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Assessment of whether contractual cash flows are SPPI

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Banking Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Banking Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Banking Group's claim to cash flows from specified assets (e.g. non-recourse loans); and
- features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Banking Group holds a portfolio of long-term fixed-rate loans for which it has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Banking Group has determined that the contractual cash flows of these loans are SPPI because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except if there is a change in the business model for managing assets. Any such reclassifications are applied in the period after the change in business model.

Financial liabilities

The Banking Group classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or FVTPL.

Designation at fair value through profit or loss

Financial assets

At initial recognition, the Banking Group may elect to designate financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, that would otherwise arise. As at 30 June 2020, the Banking Group has not elected to designate any financial assets as at FVTPL at initial recognition (30 June 2019: nil).

Financial liabilities

The Banking Group has designated certain financial liabilities as at FVTPL in either of the following circumstances:

- the liabilities are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Note 22 sets out the amount of each class of financial asset or financial liability that has been designated as at FVTPL. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

2.7 Currency

Functional and presentation currency

The Banking Group's financial statements are presented in New Zealand dollars which is the Bank's functional and presentation currency. All amounts are expressed in millions of New Zealand dollars, unless otherwise stated.

Foreign currency translation

Transactions in foreign currencies are translated into the functional currency at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the income statement. At the reporting date, foreign denominated monetary assets and liabilities are translated at the closing exchange rate, with exchange variations arising from these translations being recognised in the income statement.

2.8 Provisions

A provision is recognised in the balance sheet when the Banking Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.9 Cash flow statement

The following are definitions of the terms used in the cash flow statement:

- i) Cash and cash equivalents is considered to be cash on hand, current accounts in banks, ATMs, overnight bank deposits, net of bank overdrafts and inter-bank balances arising from the daily RBNZ settlement process.
- ii) Investing activities are those relating to the acquisition, holding and disposal of property, plant and equipment, intangibles, and other long-term assets.
- iii) Financing activities are those activities that result in changes in the size and composition of the capital structure of the Banking Group. This includes both equity and debt not falling within the definition of cash.
- iv) Operating activities include all transactions and other events that are not investing or financing activities. The holding of investment securities has been classified as an operating activity for the purposes of the cash flow statement.
- v) Certain cash flows have been netted to provide more meaningful disclosure, including changes in loans and advances to customers, deposits held by customers, balances with other banks, investment securities, and financial assets held for trading. Many of the cash flows are received and disbursed on behalf of customers and reflect the activities of the customers rather than those of the Banking Group.

2.10 Other accounting policies

Significant and other accounting policies which describe the measurement basis used and that are relevant to an understanding of the financial statements are provided throughout the notes to the financial statements.

Notes to the financial statements continued

3. Interest income and expense



Accounting policy

Recognition of interest income and expense

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments, the Banking Group estimates future cash flows considering all contractual terms of the financial instrument, but not credit impairment losses. The calculation of the effective interest rate includes transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Recognition of loan-related fees and costs

Commitment fees are deferred and, if it is probable that the commitment is exercised, recognised in income over the life of the loan as an adjustment of yield or, if unexercised, recognised in income on expiration of the commitment. Where the likelihood of exercise of the commitment is remote, commitment fees are recognised in income over the commitment period.

Direct loan origination costs are recognised over the life of the loan as an adjustment of yield. All other loan-related costs are expensed as incurred.

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19 ¹
Interest income		
Cash and cash equivalents	3	6
Due from other financial institutions	3	6
Loans and advances	863	891
Investment securities	25	30
Total interest income	894	933
Interest expense		
Due to other financial institutions	1	5
Deposits and other borrowings	376	404
Debt securities issued	54	67
Subordinated debt	1	8
Lease liabilities ²	2	-
Other interest expense	5	4
Total interest expense	439	488

¹ The comparative prior period amounts have been reclassified to align with the categories used in the current period's presentation to provide more meaningful information to users.

² The Banking Group initially applied NZ IFRS 16 at 1 July 2019, in relation to leases that were classified as operating leases. The Banking Group recognises depreciation and interest costs instead of operating lease expense. The Banking Group used the modified retrospective approach when initially applying NZ IFRS 16. Under this approach, comparative information is not restated and the cumulative effect of initially applying NZ IFRS 16 is recognised in retained earnings at the date of initial application. See notes 28 and 39.

Interest income earned from related parties is included within loans and advances. Loans and advances also includes interest from derivatives used for hedging. Interest expense paid or due to related parties is included within deposits and other borrowings and subordinated debt. See note 30 for more detail on related party transactions.

Notes to the financial statements continued

3. Interest income and expense continued

Interest income and expense by measurement category

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Interest income		
Financial assets measured at amortised cost	904	915
Financial assets measured at FVOCI	25	30
Financial assets measured at FVTPL and used for hedging	(35)	(12)
Total interest income	894	933
Interest expense		
Financial liabilities measured at amortised cost	436	475
Financial liabilities measured at FVTPL and used for hedging	3	13
Total interest expense	439	488

4. Net gains on financial instruments



Accounting policy

Accounting policies relating to gains on financial instruments at fair value are set out in notes 15, 16 and 19.

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Financial instruments held for trading	-	(2)
Net ineffectiveness on qualifying fair value hedges	1	-
Cumulative gain transferred from fair value reserve	3	-
Cumulative loss transferred from cash flow hedge reserve	-	-
Cumulative gain on financial liabilities at amortised cost	3	-
Net foreign exchange gains	6	5
Total net gains on financial instruments	13	3

Net ineffectiveness on qualifying cash flow hedges is \$nil (2019: \$nil). Net ineffectiveness on qualifying fair value hedges is \$0.4m (2019: (\$0.4m)).

Notes to the financial statements continued

5. Net fee and other income and contracts with customers



Accounting policy

A contract with a customer that results in a recognised financial instrument in the Banking Group's financial statements may be partially in the scope of NZ IFRS 9 and partially in the scope of NZ IFRS 15. If this is the case, then the Banking Group first applies NZ IFRS 9 to separate and measure the part of the contract that is in the scope of NZ IFRS 9 and then applies NZ IFRS 15 to the residual.

Gross fee and other income is recognised as services are performed and the related performance obligations are fulfilled.

Performance obligations and timing of revenue recognition

The transaction price for contracts with customers, including any estimated variable consideration, is allocated to each distinct performance obligation within each contract and revenue is recognised as those performance obligations are fulfilled.

Direct fee expenses relate mainly to transaction and service fees and commissions paid, which are directly attributable to the generation of revenue, and are recognised on an accrual basis.

Costs incurred to obtain or fulfil a contract with a customer are recognised as an asset when the costs relate directly to a specific contract, the costs improve or create resources to use in satisfying future performance obligations of the contract, and the costs are expected to be recovered in the future. The asset is amortised within operating expenses on a systematic basis consistent with the transfer to the customer of the services to which the asset relates.



Critical accounting estimates and judgements

The timing of the recognition of revenue earned from contracts with customers is based on judgements made as to how the transaction price of a contract should be allocated to the performance obligations and when those performance obligations are considered fulfilled. Where possible, this allocation is made based on the exact terms of the contracts. In the absence of exact terms allocating the transaction price to a performance obligation, an appropriate method is used to estimate the price such as an adjusted market assessment approach, expected cost plus a margin approach, the residual approach, or a combination of these methods.

The disclosure of the estimated timing of recognition of revenue related to contract liabilities is based on contract terms and relies on estimates on when certain contractual and performance obligations will be fulfilled.

The nature and timing of the satisfaction of performance obligations in contracts with customers for each type of service is outlined further below.

Notes to the financial statements continued

5. Net fee and other income and contracts with customers continued

DISAGGREGATION OF REVENUE FROM CONTRACTS WITH CUSTOMERS

The nature and timing of the satisfaction of performance obligations in contracts with customers for each type of service is outlined below:

- *Transactional account and other services* – this includes services provided to personal and business customers and covers transactional accounts and other related services. Fees are generally charged monthly or are transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place or at the time it is charged for monthly fees.
- *Card services* – this includes credit card, debit card and prepaid card services offered to personal and business customers along with related long-term contracts with card schemes. Account or set-up fees are generally charged up front at the point the card is issued with a regular renewal period. The period covered by the fee is generally six to twelve months. These types of revenue are recognised on a straight-line basis over the period covered by the fee. Certain transaction-based fees are charged and recognised as income at the point in time when the transaction takes place. For longer-term contracts, revenue is recognised over time, consistent with when the Banking Group satisfies each performance obligation based on output methods measuring the value of the services transferred to date.
- *Lending services* – this includes fees related to lending and ancillary services to personal and business customers where the revenue is not caught by NZ IFRS 9 and treated as part of the effective interest rate. Fees are generally transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place.
- *Agency services* – this includes fees related to agency services including collection and verification services. Fees are generally transaction-based fees charged at the point of the transaction. Revenue is recognised at the point in time when the transaction takes place.

In the following table, gross fee and other income from contracts with customers in the scope of NZ IFRS 15 is further disaggregated by the type of service provided to Customers.

Dollars in millions	Year ended 30/06/20			Year ended 30/06/19		
	Personal	Business	Total	Personal	Business	Total
Major service categories						
Lending services	6	4	10	7	3	10
Card services	118	1	119	107	1	108
Transactional account and other services	31	6	37	41	7	48
Agency services	1	2	3	4	12	16
Total revenue from contracts with customers	156	13	169	159	23	182
Other income	12	-	12	2	1	3
Gross fee and other income	168	13	181	161	24	185
Direct fee expenses	(94)	(2)	(96)	(89)	(6)	(95)
Total net fee and other income	74	11	85	72	18	90

The Banking Group sold the Prezzy card business to epay New Zealand Limited on 29 November 2019 with a transitional agreement in place whereby Kiwibank will operate parts of the business on behalf of epay for an ongoing fee until epay takes on the full operation and issuance of the cards. epay will manage marketing and distribution of the Prezzy card from the sale date. A total of \$12m has been recognised in the year ended 30 June 2020 within other income above in relation to the gain on sale (30 June 2019: \$nil).

In relation to insurance claims for damages suffered and losses incurred as a result of the Kaikoura earthquake on 14 November 2016, \$0m is recognised within other income (30 June 2019: \$3m). The Banking Group held insurance policies at the date of the Kaikoura earthquake that provided for cover for Material Damage and Business Interruption.

Notes to the financial statements continued

5. Net fee and other income and contracts with customers continued

Reconciliation to segment analysis

Dollars in millions	Year ended 30/06/20			Year ended 30/06/19		
	Personal	Business	Total	Personal	Business	Total
Gross fee and other income	168	13	181	161	24	185
Direct fee expenses	(94)	(2)	(96)	(89)	(6)	(95)
Net fee and other income	74	11	85	72	18	90
Net gains on financial instruments ¹	2	11	13	(1)	4	3
Other external operating income²	76	22	98	71	22	93

¹ As presented in note 4 – net gains on financial instruments

² As presented in note 32 – segment analysis

CONTRACT BALANCES

Contract liabilities

Dollars in millions	30/06/20	30/06/19
Contract liabilities	10	27
Total contract liabilities	10	27
Current	6	23
Non-current	4	4

The Banking Group's contract liabilities relate to non-refundable up-front fees received for card products with primarily short-term contracts from six to twelve months and up-front revenue received for long-term contracts that may be partially refundable where the terms of the contract are not met. Income is recognised and spread consistently over time as the relevant performance obligations are fulfilled.

During the year ended 30 June 2020, \$17.8m of the opening contract liability has been recognised as revenue as the relevant performance obligations have been satisfied during the period (30 June 2019: \$5.6m).

Estimated timing of income recognition

The following table provides information about the estimated timing of income recognition related to the contract liabilities of the Banking Group.

Dollars in millions	30/06/20				Total
	Up to 12 months	Between 1 and 2 years	Between 2 and 3 years	More than 3 years	
Short-term contracts	3	-	-	-	3
Long-term contracts	3	1	1	2	7
Total contract liabilities	6	1	1	2	10

Dollars in millions	30/06/19				Total
	Up to 12 months	Between 1 and 2 years	Between 2 and 3 years	More than 3 years	
Short-term contracts	5	-	-	-	5
Long-term contracts	18	1	1	2	22
Total contract liabilities	23	1	1	2	27

Notes to the financial statements continued

5. Net fee and other income and contracts with customers continued

Costs to fulfil assets

The following table provides the closing balances of assets recognised from the costs incurred to fulfil contracts with customers.

Dollars in millions	30/06/20	30/06/19
Costs to fulfil assets	5	4
Accumulated amortisation	(4)	-
Total costs to fulfil assets	1	4

No impairment losses were recognised in relation to costs to fulfil assets during the year ended 30 June 2020 (30 June 2019: \$nil).

6. Operating expenses



Accounting policy

Operating expense recognition

Operating expenses are recognised on an accrual basis in the period services are provided, over the period in which assets are consumed, or as liabilities are created.

Employee benefits

Employee entitlements to salaries and wages, bonuses, annual leave, long-service leave, retiring leave and other similar benefits are recognised in the income statement when they accrue to employees.

Obligations for contributions to defined contribution retirement plans are recognised as an expense in the income statement as they fall due.

Operating leases

Policy applicable from 1 July 2019

The Banking Group applied NZ IFRS 16 *Leases* from 1 July 2019. In applying NZ IFRS 16, in relation to the leases that were classified as operating leases, it recognises the depreciation expense related to right-of-use assets within operating expenses and interest costs related to lease liabilities within interest expense. Refer to note 28 for more detail on the accounting policy for leases.

Policy applicable before 1 July 2019

Payments made under operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in the income statement on a straight-line basis over the term of the lease. Leasehold improvements are capitalised and the cost is amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is shorter. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Salaries and wages	187	161
Other personnel-related costs	24	14
Leasing and premises costs	12	20
Information technology and system costs	54	47
Office supplies, postage and phone	11	10
Consultancy and professional fees	23	22
Marketing and customer communications	19	17
Amortisation	26	25
Depreciation	12	12
Depreciation on right-of-use assets	14	-
Other expenses	46	47
Total operating expenses	428	375

Notes to the financial statements continued

6. Operating expenses continued

	Year ended	Year ended
Dollars in thousands	30/06/20	30/06/19
Directors' fees	956	995

7. Taxation



Accounting policy

The income tax expense charged to the income statement includes both current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the current year, using tax rates enacted or substantively enacted at the reporting date, after taking advantage of all allowable deductions under current taxation legislation and any adjustment to tax payable in previous years.

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date. A deferred taxation benefit is recognised only to the extent that it is probable that a future taxable profit will be available against which the temporary differences can be utilised.

Current or deferred tax related to fair value measurement of investment securities and cash flow hedges, which is charged or credited to other comprehensive income, is subsequently recognised in the income statement if and when the deferred gain or loss on the related asset or liability affects profit or loss.

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority and there is a legal right and intention to settle on a net basis and it is allowed under tax law.

Notes to the financial statements continued

7. Taxation continued

Income tax expense

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Profit before taxation	74	151
Tax calculated at a rate of 28%	(21)	(42)
Tax effect of:		
Income not subject to tax and non-deductible expenses	(1)	(8)
Transfer of tax losses from other KGHL subsidiaries	5	7
Tax charge as per the income statement	(17)	(43)
Represented by:		
Current income tax	(32)	(47)
Deferred income tax	15	4
Tax charge as per the income statement	(17)	(43)
The deferred tax charge in the income statement comprises the following temporary differences:		
Accelerated tax depreciation	2	2
Other provisions and accruals	-	1
Allowances for credit and other impairment losses	13	1
Total movement in temporary differences	15	4

Deferred taxation

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Deferred tax		
Balance at beginning of the year	21	11
Prior period adjustment	(1)	(1)
Transitional adjustments resulting from the adoption of NZ IFRS 9 and NZ IFRS 15	-	1
Movement in temporary differences	16	5
Tax on profits taken to reserves	7	5
Balance at end of the year	43	21
Deferred income tax assets		
Cash flow hedges	16	9
Other provisions and accruals	8	8
Allowance for loan impairment	24	11
Total deferred income tax assets	48	28
Deferred income tax liabilities		
Accelerated tax depreciation	(5)	(7)
Total deferred income tax liabilities	(5)	(7)
Net deferred taxation	43	21

Notes to the financial statements continued

8. Loans and advances



Accounting policy

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently at amortised cost using the effective interest method. Interest income, expected credit losses (“ECL”) and reversals are recognised in the income statement.

The following table presents gross loans and advances by type of product. Total gross residential mortgage loans at 30 June 2020 were \$20,315m (2019: \$18,894m). This includes *term loans – housing* and residentially secured lending within *other term lending* (see note 10).

Dollars in millions	Year ended	Year ended
	30/06/20	30/06/19
Overdrafts	107	94
Credit card outstandings	389	398
Term loans - housing	19,377	17,977
Other term lending	2,234	1,837
Other lending	201	177
Gross loans and advances	22,308	20,483
Provision for credit impairment	(86)	(40)
Fair value hedge adjustments	-	-
Net loans and advances	22,222	20,443
Current	1,517	1,507
Non-current	20,705	18,936

Business Finance Guarantee Scheme

The Minister of Finance established the Business Finance Guarantee Scheme (the “Scheme”) in April 2020 to help banks support New Zealand businesses facing hardship as a consequence of COVID-19 via an indemnity pursuant to section 65ZD of the Public Finance Act 1989.

On 13 April 2020, the Bank entered into a deed of indemnity with the Crown to implement the Scheme. The Scheme allowed the Bank to lend up to \$500,000 to qualifying borrowers for a maximum of three years. On 20 August 2020, the Bank entered into a new deed of indemnity allowing the Bank to lend up to \$5,000,000 to qualifying borrowers for a maximum of five years. Subject to compliance with the terms of the deed, the Crown will pay 80% of any loss incurred by the Bank on loans made under this scheme, with the remaining 20% carried by the Bank. There are no other limits on the amount of the obligations guaranteed. The amount of loans issued under this scheme are disclosed within note 9.

Notes to the financial statements continued

9. Credit impairment losses



Accounting policy

The Banking Group recognises credit impairment provisions for expected credit losses (“ECL”) on the following financial instruments:

- financial assets measured at amortised cost;
- debt instruments measured at fair value through other comprehensive income (“FVOCI”);
- lease receivables; and
- certain loan commitments and financial guarantees.

Measurement of ECL

A three-stage approach is applied to measuring ECL based on credit migration between the stages as follows:

Stage 1: At initial recognition, a provision equivalent to 12 months of ECL is recognised.

Stage 2: Where there has been a significant increase in credit risk since initial recognition, a provision equivalent to full lifetime ECL is recognised.

Stage 3: This stage comprises all accounts that are impaired or in default. Lifetime ECL is recognised for loans where there is objective evidence of impairment.

ECL are probability-weighted and determined by evaluating a range of possible outcomes, taking into account the time value of money, past events, current conditions and forecasts of future economic conditions.

The ECL models use three main components to determine expected credit loss (as well as the time value of money), including:

- probability of default (“PD”): the probability that a counterparty will default;
- loss given default (“LGD”): the loss that is expected to arise in the event of default; and
- exposure at default (“EAD”): the estimated outstanding amount of credit exposure at the time of default.

These models incorporate past experience, current conditions and multiple probability-weighted macroeconomic scenarios to generate credit loss estimates under reasonably supportable future economic conditions.

Changes to ECL are assessed through four economic scenarios:

- a central scenario reflecting the expected track for the economy;
- a mild upside scenario;
- a mild downside scenario; and
- a severe stress scenario.

The macroeconomic variables used in these scenarios are based on current economic forecasts and are the Consumer Price Index (“CPI”), Gross Domestic Product (“GDP”), unemployment rate, interest rates, and the house price index. The probability weightings attached to each scenario are reviewed by executive management at least half-yearly, with the scenarios and the associated probability weightings reviewed more frequently when there are material changes in macroeconomic conditions impacting the economy. Details of the scenarios and the probability weightings applying at year-end are outlined in this note.

The determination of a significant increase in credit risk (i.e. the movement from stage 1 to stage 2) is based on changes in internally assessed customer risk characteristics since origination of the facility. Those changes include arrears on loan facilities (at or less than the 30-day backstop), material movements in risk grades or behavioural scores, or other information the Banking Group becomes aware of which indicates that repayment on the original terms and conditions may now be uncertain. The movement between stages 2 and 3 is based on whether financial assets are credit impaired at the reporting date.

The impacts on the accounting policies of COVID-19, and changes made to economic scenario assumptions and scenario weightings are detailed in the note below.

Credit-impaired financial assets

At each reporting date, the Banking Group assesses whether financial assets carried at amortised cost and debt instruments measured at FVOCI are credit impaired. A financial asset is ‘credit impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset may be credit impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Banking Group on terms that it would not consider otherwise;
- the borrower entering bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

Notes to the financial statements continued

9. Credit impairment losses continued



Accounting policy continued

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. A retail loan that is overdue for 90 days or more is considered credit impaired.

Presentation of allowance for ECL in the balance sheet

Credit impairment provisions for ECL are presented in the balance sheet as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- where a financial instrument includes both a drawn and an undrawn component, the Banking Group presents a combined credit impairment provision for both components; and
- debt instruments measured at FVOCI: no loss allowance is recognised in the balance sheet because the carrying amount of these assets is their fair value. However, the credit impairment provision is disclosed and recognised in the fair value reserve.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Banking Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'credit impairment losses' in the statement of profit or loss and other comprehensive income.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Banking Group's procedures for recovery of amounts due.



Critical accounting estimates and judgements

Loan portfolios are assessed for impairment on a monthly basis. In determining whether an impairment loss should be recorded in the income statement, judgements are made as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

In determining ECL, management makes a number of key judgements and assumptions, including but not limited to the following components:

- modelling inputs and methodologies
- the factors that determine when an exposure moves to or from 12-month and lifetime ECL calculations
- the realisable value of collateral
- the level of each of the macroeconomic factors used within each of the economic scenarios
- the weightings given to each economic scenario
- any overlays required to estimate impairments due to potential loss events that could occur (such as natural disasters) as well as loss events that have occurred but where those impacts are not yet incorporated into the ECL models (including COVID-19).

These judgements and assumptions are reviewed and assessed at least half-yearly and when underlying economic conditions materially change.

The impact on judgements and assumptions as a result of COVID-19 is detailed in the note below.

Notes to the financial statements continued

9. Credit impairment losses continued

Dollars in millions	Year ended 30/06/20			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
(Charged)/credited to the income statement for collectively assessed provisions	(9)	(25)	(13)	(47)
(Charged)/credited to the income statement for individually assessed provisions	-	-	(1)	(1)
Amounts written off directly to the income statement	(7)	-	-	(7)
Recovery of amounts previously written off	4	-	-	4
Total credit impairment losses per income statement	(12)	(25)	(14)	(51)

Dollars in millions	Year ended 30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Credited/(charged) to the income statement for collectively assessed provisions	1	(2)	(6)	(7)
Credited/(charged) to the income statement for individually assessed provisions	1	-	1	2
Amounts written off directly to the income statement	(10)	(1)	-	(11)
Recovery of amounts previously written off	4	-	-	4
Total credit impairment losses per income statement	(4)	(3)	(5)	(12)

IMPACT OF COVID-19 ON CREDIT IMPAIRMENT LOSSES AND CREDIT IMPAIRMENT PROVISIONS FOR THE YEAR ENDED 30 JUNE 2020

COVID-19 has had a significant impact on global and domestic economies and a direct impact on many of the Banking Group's customers. It has also introduced a considerable amount of uncertainty in terms of the outlook for the global and domestic economies, the inputs used in the ECL model and the potential impacts on customers. The specific areas of uncertainty and judgement due to COVID-19 are described in more detail below including an explanation of the critical accounting estimates and judgements related to the COVID-19-related overlay.

As at 30 June 2020, Kiwibank customers had access to a wide range of support packages. Mortgage lending support was primarily provided through the mortgage payment deferral scheme which was available to all Retail and Small Business customers. Details of the utilisation of that scheme are provided later in this section. In addition, Business customers had access to various government assistance schemes including wage subsidies, the Business Finance Guarantee Scheme and the IRD's Small Business Cashflow loan scheme. As a result of that extensive credit support the traditional indicators of increased credit risk (excesses, delinquencies and impairments) have been masked so that the credit impacts of COVID-19 on the Bank's customers are not fully recognised in the ECL models.

Customers accessing these support packages have not been automatically assessed as being subject to a significant increase in credit risk (i.e. transitioned from stage 1 to stage 2 and assessed with lifetime ECL). The IASB issued *IFRS 9 and COVID-19 – accounting for expected credit losses* in late March 2020 which held that these support packages were short-term in nature and were provided to cover customer's cash-flow requirements while economies were disrupted by lockdown rules. On 26 March 2020, the RBNZ confirmed that guidance would apply to New Zealand banks for a six-month period during which these supported loans should be considered fully performing and not treated as being in arrears or restructured assets while the terms of the support arrangements were met. The RBNZ have recently confirmed the mortgage payment deferral scheme has been extended to 31 March 2021 with the expectation these customers will return their loans to a full repayment basis as soon as their financial circumstances allow. The Business Finance Guarantee Scheme, IRD Cash Settlement Schemes, and wage subsidy have also been extended, and the ultimate term of these schemes is uncertain. The expiration of those schemes without the effective elimination of COVID-19 will impact future ECL estimates.

Assessing the impact of COVID-19 on credit impairment has been achieved by applying a range of economic scenarios to the ECL models and raising additional provision overlays. Specific COVID-19 overlays have been developed for each of the mortgage and business portfolios. These overlays comprise management estimates of the value of mortgage payment deferral scheme loans that modelling indicates would have experienced a significant increase in credit risk had that support not been provided. These estimates are probability-weighted to reflect differing estimates across each of the four economic scenarios. It is important to note these exposures are currently considered fully performing (they remain in stage 1) but that a provision overlay has been assessed due to the increased underlying risk. It is expected that most of these customers will restore their pre-COVID-19 repayment terms at the end of these lending support arrangements and will continue to be assessed as fully performing (stage 1). However, it recognises that some of these customers could face a deterioration in their credit performance due to business failure, loss of employment, or a permanent reduction in income.

Notes to the financial statements continued

9. Credit impairment losses continued

The following tables show the total drawn exposure and number of customers provided with lending support packages related to COVID-19 as at 30 June 2020 (30 June 2019: nil).

Total drawn exposure	Year ended 30/06/20			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Dollars in millions				
COVID-19 Interest Only	1	1,009	53	1,063
COVID-19 Repayment Deferral	-	838	10	848
COVID-19 Term Extension	-	19	-	19
Credit Card Assistance	4	-	-	4
Retail Overdraft Package	-	-	-	-
Business Finance Guarantees	-	-	8	8
COVID-19 Increased Funding	-	-	10	10
Total drawn exposure	5	1,866	81	1,952

Customers with support arrangements	Year ended 30/06/20			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Number of customers				
COVID-19 Interest Only	3	2,981	163	3,147
COVID-19 Repayment Deferral	-	2,178	19	2,197
COVID-19 Term Extension	-	81	-	81
Credit Card Assistance	475	-	-	475
Retail Overdraft Package	651	-	-	651
Business Finance Guarantees	-	-	51	51
COVID-19 Increased Funding	-	-	218	218
Total number of customers	1,129	5,240	451	6,820

Changes in ECL models and assumptions inputs

The movement in the provision for credit impairment for the year ended 30 June 2020 is summarised below.

Dollars in millions	As at	Movement	As at
	30/06/20		30/06/19
Individually assessed provisions	2	(1)	3
Collectively assessed provisions			
- Modelled ECL	58	29	29
- Model overlays	26	18	8
Total provision for credit impairment	86	46	40

The movement in the provision for credit impairment as a result of the impacts of COVID-19 is reflected in the table above. This movement is driven by changes in model inputs, changes in scenario weightings (included within the modelled ECL movements), and through adjustments to model overlays.

Changes in ECL model inputs

The modelled provision for expected credit losses is an estimate of forward-looking losses based on the Banking Group's view of four different economic scenarios. Kiwibank's assumptions around the macroeconomic factors used within each scenario and the weighting applied to each scenario are key judgements applied to the ECL models. As a result of COVID-19, the Banking Group has adjusted the macroeconomic variables used in the ECL model based on current economic forecasts. The weightings assigned to each scenario have been reassessed and reflect the increased uncertainty and potential downside risks for the domestic economy.

The Banking Group's four macroeconomic scenarios have been updated during the year ended 30 June 2020 as follows.

- **Central scenario (COVID-19 single extended lockdown – medium-term impact):** this is the Banking Group's base case assumption which covers forward-looking credit risk against GDP, house prices, unemployment, interest rates and CPI. The base case assumes the impacts of COVID-19 on the New Zealand economy continue into the medium-term.

Notes to the financial statements continued

9. Credit impairment losses continued

- **Upside scenario (COVID-19 single lockdown event – short-term impact):** this scenario reflects more favourable macroeconomic conditions than the central scenario which leads to lower than expected credit losses. The upside scenario is a more positive outlook and assumes that COVID-19 will have a short-term impact on the New Zealand economy.
- **Downside scenario (COVID-19 multiple lockdowns – longer term impact):** this scenario reflects more unfavourable macroeconomic conditions than the central scenario. This scenario will lead to higher than expected credit losses reflecting a deterioration in the credit risk factors. The downside scenario assumes that New Zealand will enter a second and then subsequent lockdowns, and COVID-19 will have a long-term economic impact.
- **Severe stress scenario (Regulator stress test scenario with an extended recession):** this scenario is based on the severe economic stress test scenarios that are used in regulator stress testing across several jurisdictions including New Zealand, Australia, the UK and the US. It reflects a more prolonged contraction to the economy and more severe impacts on house prices.

The expected trajectory for the domestic economy remains highly uncertain given the continuing impacts of the pandemic on global trade patterns, commodity prices, and the flow of international tourists and students. While the Government and the RBNZ have provided significant levels of fiscal and monetary support to the New Zealand economy, it is difficult to predict the levels of continuing support required and whether the economy will respond as forecast. The economic scenarios and consequent provision impacts will continue to be assessed as the situation develops and as more data becomes available to better model the potential credit losses that may result from the impact of COVID-19 on the New Zealand economy.

The changes in the variables and weighting used at 30 June 2020 compared to 30 June 2019 are presented on the following pages.

Scenario		30/06/20	30/06/19
Central June 2020: COVID-19 Single extended lockdown	GDP	GDP falls 18.3% YoY in June 2020 quarter and doesn't return to 2020 levels until 2022.	Continuing benign economic conditions with annual average YoY GDP growth between -2-3%.
	Unemployment	Unemployment reduces slowly from 9.8% to 5.3% by 2023.	Stable unemployment (~4%) projected.
	House price index	House prices fall ~10% from pre-lockdown levels and are slow to recover.	House prices increasing ~2-3% per annum.
Upside June 2020: COVID-19 Single lockdown event	GDP	Economy recovers more quickly than in the Central scenario with GDP returning to 2020 levels by mid-2021.	Similar to the Central scenario but annual average YoY GDP growth is higher in the outer years.
	Unemployment	Unemployment peaks at 9% and then reduces slowly.	Stable unemployment (~4%) projected.
	House price index	House prices fall ~10% from pre-lockdown levels recovering by end of 2022.	House prices increasing 4-6% per annum.
Downside June 2020: COVID-19 Multiple lockdowns	GDP	GDP recovers more slowly from COVID-19 due to a second (and subsequent) round of infection requiring further periods of lockdown.	Average annual GDP growth drops to 1.5% over the first year before recovering to an annual average YoY growth of ~3%.
	Unemployment	Unemployment peaks at 13.4% before falling slowly to <8% by the second half of 2023.	Unemployment increases to 5.7%.
	House price index	House prices fall ~20% from their peak and don't recover to pre-lockdown levels by 2023.	House prices fall marginally before returning to annual growth of ~3-4% by 2022.
Severe stress Regulator stress test with extended recession	GDP	No material change from 30 June 2019	Annual average GDP growth falls to -2% by the second year of the scenario, not recovering to the starting level until the end of year 3.
	Unemployment	No material change from 30 June 2019	Unemployment increases and peaks above 10%
	House price index	No material change from 30 June 2019	House prices decrease ~35% from their peak.

Notes to the financial statements continued

9. Credit impairment losses continued

The weightings applied to the scenarios in the calculation of ECL as at 30 June 2020 are outlined below.

Scenario weighting applied	30/06/20	30/06/19
Central	40%	60%
Upside	10%	20%
Downside	40%	15%
Severe stress	10%	5%

Changes in model overlays

Model overlays are required in circumstances where it is judged that the existing inputs, assumptions and model techniques do not capture all the risk factors relevant to the Banking Group's lending portfolios. The Bank holds a number of overlays reflecting credit risks that are not yet incorporated into ECL models due to data gaps in limited loss histories, limitations in model design and for risk drivers the Bank is unable to currently estimate with sufficient precision.

The total model overlay as at 30 June 2020 was \$26.3m which includes COVID-19 related overlays of \$19.8m (30 June 2019: total model overlay of \$8.3m). The COVID-19-related overlay for retail mortgages has been calculated as \$14.3m. A COVID-19-related overlay is required as the ECL models do not fully capture the credit risk related to loans and credit commitments where there has been a significant increase in credit risk as a result of the economic impacts of COVID-19 that are masked through temporary support from various central bank, government and bank support packages including wage subsidies, Small Business Cashflow Loans issued by Inland Revenue, and payment deferrals.

The Banking Group's COVID-19 overlay is calculated on the assumption that a proportion of these impacted customers, who are currently receiving COVID-19 related lending support, wage subsidies or other forms of government support will ultimately experience arrears, hardship, or default without the various support arrangements in place. This overlay reflects the uncertainty of the impact of the temporary support arrangements and applies judgement in assessing a probability-weighted forecast of what the Banking Group expects to occur when supporting arrangements for customers are removed.

The Bank continues to review the basis for calculating those overlays as they are dependent on estimates of credit deterioration which are, in turn, dependent on the future economic environment, the continuing path of the pandemic both within New Zealand and globally, and any subsequent agreements to extend those arrangements.

Sensitivity of ECL to key judgements and assumptions

The uncertain evolution of the COVID-19 pandemic increases the risk that the forecast assumptions applied will result in an understatement or overstatement of the provision for credit impairment. Given this uncertainty and as the impact of judgements is significant, a sensitivity analysis is included below to outline the impact of applying different scenario weightings and overlay assumptions on the level of ECL.

To illustrate the variability of ECL to different forecast assumptions, the following table outlines the sensitivity of ECL by giving each economic scenario a 100% weighting and adjusting the forecast assumptions applied for the calculation of the COVID-19 overlay accordingly while holding all other modelling factors constant. The impact below represents the increase or (decrease) in the ECL provision by applying the different assumptions noted.

Dollars in millions	Total ECL	Impact
Reported probability-weighted ECL	86	-
100% upside scenario ECL	52	(34)
100% central scenario ECL	77	(9)
100% downside scenario ECL	99	13
100% severe stress ECL	112	26

Uncertainty surrounding the impact of COVID-19 is reflected in an equal weighting being given to the central (extended COVID-19 lockdown) and downside (multiple COVID-19 lockdowns) scenarios in the Banking Group's ECL estimates as at 30 June 2020. Significant adjustments to those estimates are likely over the coming years as the economy responds to economic and societal consequences of COVID-19 in ways that are currently difficult to predict.

Notes to the financial statements continued

10. Asset quality

Summary of lending

Dollars in millions	Year ended 30/06/20			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Neither past due nor impaired	392	20,253	1,556	22,201
Past due but not impaired	17	61	27	105
Impaired	-	1	1	2
Gross loans and advances	409	20,315	1,584	22,308
Provision for credit impairment	(19)	(40)	(27)	(86)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	390	20,275	1,557	22,222

Dollars in millions	Year ended 30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Neither past due nor impaired	406	18,784	1,140	20,330
Past due but not impaired	25	107	16	148
Impaired	-	3	2	5
Gross loans and advances	431	18,894	1,158	20,483
Provision for credit impairment	(10)	(16)	(14)	(40)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	421	18,878	1,144	20,443

Loans and advances past due but not impaired

Dollars in millions	Year ended 30/06/20			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Past due less than 30 days	14	34	14	62
Past due 30 - 59 days	2	8	4	14
Past due 60 - 89 days	1	7	2	10
Past due 90 days or greater	-	12	7	19
Total loans and advances past due but not impaired	17	61	27	105

Dollars in millions	Year ended 30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Past due less than 30 days	21	82	12	115
Past due 30 - 59 days	3	6	2	11
Past due 60 - 89 days	1	7	1	9
Past due 90 days or greater	-	12	1	13
Total loans and advances past due but not impaired	25	107	16	148

Notes to the financial statements continued

10. Asset quality continued

Other asset quality information

Dollars in millions	Year ended 30/06/20			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Undrawn lending commitments to counterparties with individually impaired assets	-	-	1	1
Other assets under administration	-	-	1	1

Dollars in millions	Year ended 30/06/19			Total
	Retail unsecured lending	Residential mortgage loans	Business exposures	
Undrawn lending commitments to counterparties with individually impaired assets	-	-	-	-
Other assets under administration	-	-	-	-

Movement in provision for credit impairment and gross carrying amounts

The following pages include tables summarising the movement in provision for credit impairment split by category of retail unsecured lending, residential mortgage loans, and business exposures. Aggregate information for all categories is presented also.

The movement tables are presented on the following basis:

- Additions are amounts drawn from new or existing facilities during the year.
- Deletions are amounts repaid during the year.
- Transfers between ECL stages show the impact of the initial transfer.
- Net remeasurement of loss allowance includes the subsequent increase or decrease of the provision for transferred amounts and the impact of changes in credit quality of existing lending.
- Other changes in ECL includes the impact of non-significant changes in the credit quality of existing lending, changes in future forecast assumptions and other model or overlay changes.

Notes to the financial statements continued

10. Asset quality continued

Movement in provision for credit impairment – retail unsecured lending

Dollars in millions	Year ended 30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year - retail unsecured lending	5	5	-	-	10
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	-	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	(1)	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	3	1	-	3
- Changes due to additions and deletions	2	3	1	-	6
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	1	1	-	-	2
Total charged/(credited) to income statement for collectively assessed provisions	2	5	2	-	9
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of the year - retail unsecured lending	8	9	2	-	19

Impact of changes in gross financial assets on loss allowances – retail unsecured lending

Dollars in millions	Year ended 30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – retail unsecured lending					
Balance at the beginning of the year	311	119	1	-	431
Net transfers between stages	23	(25)	2	-	-
Additions	110	48	2	-	160
Deletions	(144)	(30)	(1)	-	(175)
Amounts written off	-	(7)	-	-	(7)
Balance at end of the year – retail unsecured lending	300	105	4	-	409

Notes to the financial statements continued

10. Asset quality continued

Overall, credit impairment provisions for retail unsecured lending exposures increased a net \$9m for the year ended 30 June 2020. Much of that charge is due to the uncertain impacts of COVID-19 on the economy and unemployment, and the material deterioration in the economic scenarios used in the Bank's provision models.

- Stage 1 collectively assessed: collective provisions increased \$3m due to the increased provisioning on new and existing accounts from the new economic scenarios. Total new and additional lending of \$110m was offset by repayments of \$144m (largely a result of reduced spending during the COVID-19 lockdown period). While on-balance-sheet lending reduced, overall exposures increased with greater undrawn limits supporting the higher collective provision change. A net \$23m of drawn exposure, with provisions of \$1m was transferred from stage 2 to stage 1 but was offset by the decrease of \$1m from remeasurement.
- Stage 2 collectively assessed: collective provisions increased \$4m as a result of the new economic scenarios despite balances decreasing \$14m. A \$3m increase of stage 2 provision was the result of net \$18m growth in balances from new customers. Another \$3m of provision was recognised due to the remeasurement of customers transferring to stage 2. These increases were offset by the release of \$2m of provision from the \$7m balance written off during the year.
- Stage 3 collectively assessed: collective provisions increased \$2m as a result of a net \$3m increase in balances under repayment arrangements. Provisions increased by \$1m from remeasurement as balances were transferred from stage 2 to stage 3, and \$1m on new stage 3 customers. Stage 3 remain minimal as the Bank has a policy of writing balances off once they are 90 days delinquent. The \$4m loan balance in this stage is mainly customers with repayment arrangements under the Bank's COVID-19 lending support arrangements.

Movement in provision for credit impairment – residential mortgage loans

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year - residential mortgage loans	8	3	3	2	16
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	1	(1)	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	-	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	1	1	-	1
- Changes due to additions and deletions	-	-	(1)	-	(1)
- Changes due to amounts written off	-	-	-	-	-
- Other changes	24	1	-	-	25
Total charged/(credited) to income statement for collectively assessed provisions	23	2	-	-	25
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Balance at end of the year – residential mortgage loans	32	5	2	1	40

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross financial assets on loss allowances – residential mortgage loans

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – residential mortgage loans					
Balance at beginning of the year	18,263	610	18	3	18,894
Net transfers between stages	(47)	41	6	-	-
Additions	4,843	133	1	-	4,977
Deletions	(3,414)	(130)	(10)	(1)	(3,555)
Amounts written off	-	-	-	(1)	(1)
Balance at the end of the year – residential mortgage loans	19,645	654	15	1	20,315

Mortgage provisions increased by \$24m for the year ended 30 June 2020. This is a result of \$1.4b loan balance growth, updated economic scenarios and an increase in the management overlays to reflect credit risks not incorporated in the Bank's ECL models. The largest of those overlays includes an additional provision for the credit deterioration on mortgage lending expected following the impact of COVID-19. This specific COVID-19 overlay has been modelled against the probability that some loans would have been downgraded to stage 2 had lending support arrangements not been in place.

- Stage 1 collectively assessed: collective provisions increased \$24m largely as a result of new economic scenarios and the increased overlays to reflect the forecast economic impact of COVID-19. A total of \$1.4b of net new lending attracts very low levels of collective provision as very low loss rates are expected in the 12 months following origination. A total of \$1m of collective provisions transferred from stage 2 was offset by the decrease from remeasuring the balance in stage 1.
- Stage 2 collectively assessed: collective provisions increased \$2m as a result of a net \$41m of mortgage balances transferring from stage 1 as well as remeasurement, economic scenarios and overlay increases.
- Stage 3 collectively assessed: collective provisions decreased by \$1m due to a net decrease of \$3m in stage 3 lending. The transfer of \$1m of provisions from stage 3 was offset by remeasurement on lending that had been transferred to stage 3 over the year.
- Stage 3 individually assessed: specific provisions decreased \$1m due to amounts written off.

Notes to the financial statements continued

10. Asset quality continued

Movement in provision for credit impairment – business exposures

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year - business exposures	6	6	1	1	14
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	-	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	(1)	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	1	-	-	-
- Changes due to additions and deletions	4	-	2	-	6
- Changes due to amounts written off	-	-	-	-	-
- Other changes	6	1	-	-	7
Total charged/(credited) to income statement for collectively assessed provisions	9	2	2	-	13
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	1	1
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Balance at end of the year – business exposures	16	7	3	1	27

Impact of changes in gross financial assets on loss allowances – business exposures

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – business exposures					
Balance at the beginning of the year	1,102	52	2	2	1,158
Net transfers between stages	(26)	25	1	-	-
Additions	741	23	6	1	771
Deletions	(324)	(18)	(1)	(1)	(344)
Amounts written off	-	-	-	(1)	(1)
Balance at end of the year – business exposures	1,493	82	8	1	1,584

Notes to the financial statements continued

10. Asset quality continued

Credit impairment provisions for business exposures increased a net \$13m for the year ended 30 June 2020. This is a result of \$426m of loan balance growth, updated economic scenarios and increases in the management overlays to reflect credit risks not included in the Bank's ECL models. The largest of those overlays includes an additional provision for the credit deterioration on business lending expected following the impact of COVID-19. This specific COVID-19 overlay has been modelled against the probability that some existing and temporary loan balances would have been downgraded to stage 2 had lending support arrangements not been put place.

- Stage 1 collectively assessed: collective provisions increased \$10m driven by a net increase of \$391m in gross balances generating \$4m of provisions, \$6m overlay addition relating to COVID-19 impacts, and other increases in management overlays. A net \$1m collective provision was transferred from stage 2 to stage 1, offset by a \$1m reduction in remeasurement.
- Stage 2 collectively assessed: collective provisions increased \$1m from a net increase in gross balances of \$30m. The decrease in provision of \$1m from lending transferred to stage 1 was offset by a \$1m remeasurement of balances transferring to stage 2. An increase of \$1m of collective provisions was added for adjustments relating to the new economic scenarios and increased overlays.
- Stage 3 collectively assessed: collective provisions increased \$2m due to \$6m of growth in stage 3 lending.
- Stage 3 individually assessed: specific provisions remained at \$1m over the year. New impaired lending offset repayments and write-offs on existing lending resulted in an impaired loan balance of \$1m as at 30 June 2020.

Movement in provision for credit impairment – total exposures

Dollars in millions	30/06/20				
	Stage 1	Stage 2	Stage 3		Total
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year - total exposures	19	14	4	3	40
Transfers between stages:					
- Transferred to Stage 1	3	(3)	-	-	-
- Transferred to Stage 2	-	1	(1)	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	3	(2)	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(3)	5	2	-	4
- Changes due to additions and deletions	6	3	2	-	11
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	31	3	-	-	34
Total charged/(credited) to income statement for collectively assessed provisions	34	9	4	-	47
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	1	1
Amounts written off from individually assessed provisions	-	-	-	(2)	(2)
Balance at end of the year – total exposures	56	21	7	2	86

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross financial assets on loss allowances – total exposures

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – total exposures					
Balance at beginning of the year	19,676	781	21	5	20,483
Net transfers between stages	(50)	41	9	-	-
Additions	5,694	204	9	1	5,908
Deletions	(3,882)	(178)	(12)	(2)	(4,074)
Amounts written off	-	(7)	-	(2)	(9)
Balance at end of the year – total exposures	21,438	841	27	2	22,308

Prior period movement in provision for credit impairment – retail unsecured lending

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year – retail unsecured lending	5	6	-	1	12
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	-	-	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	-	1	-	-	1
- Changes due to additions and deletions	-	-	-	-	-
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	-	(1)	-	-	(1)
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	(1)	(1)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of the year – retail unsecured lending	5	5	-	-	10

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross financial assets on loss allowances – retail unsecured lending

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – retail unsecured lending					
As at beginning of the year	300	121	1	1	423
Net transfers between stages	-	-	-	-	-
Additions	43	31	2	-	76
Deletions	(32)	(23)	(2)	(1)	(58)
Amounts written off	-	(10)	-	-	(10)
Balance at end of the year – retail unsecured lending	311	119	1	-	431

Overall, credit impairment provisions for retail unsecured lending exposures decreased a net \$2m for the year ended 30 June 2019.

- Stage 1 collectively assessed: collective provision on stage 1 unsecured assets was unchanged. New lending of \$43m was largely offset by \$32m of repayments generating an immaterial collective provision charge reflecting low expected losses on newly originated lending. There was a \$1m reduction of stage 1 collective provision due to \$11m of exposures moving to stage 2 due to evidence of credit deterioration. This was matched by \$11m of stage 2 exposures demonstrating improved credit quality and moving back to stage 1 requiring an additional \$1m of stage 1 collective provision.
- Stage 2 collectively assessed: collective provision reduced \$1m following a net reduction of \$2m in stage 2 balances over the year. A \$1m increase of collective provision was driven by a \$31m increase in stage 2 balances along with the \$11m transferred from stage 1 but that was offset by \$23m of balances repaid with another \$10m written off.
- Stage 3 collectively assessed: collective provision is minimal for this stage as the Bank has a policy of writing off balances once they are 90 days delinquent. There is a small balance of \$1m in this stage comprising customers greater than 90 days delinquent and not yet written off due to timing or due to the exposure being impaired for reasons other than 90 day delinquency.
- Stage 3 individually assessed: specific provisions reduced by \$1m as these exposures were repaid. There were no individually assessed provisions for unsecured lending as at 30 June 2019.

Notes to the financial statements continued

10. Asset quality continued

Prior period movement in provision for credit impairment – residential mortgage loans

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year – residential mortgage loans	7	4	1	2	14
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	-	-	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	-	-	1	-	1
- Changes due to additions and deletions	1	(1)	1	-	1
- Changes due to amounts written off	-	-	-	-	-
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	1	(1)	2	-	2
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of the year – residential mortgage loans	8	3	3	2	16

Prior period impact of changes in gross financial assets on loss allowances – residential mortgage loans

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – residential mortgage loans					
As at beginning of the year	16,463	591	9	5	17,068
Net transfers between stages	10	(12)	1	1	-
Additions	4,689	159	16	-	4,864
Deletions	(2,899)	(128)	(8)	(2)	(3,037)
Amounts written off	-	-	-	(1)	(1)
Balance at end of the year – residential mortgage loans	18,263	610	18	3	18,894

Notes to the financial statements continued

10. Asset quality continued

Overall, credit impairment provisions for residential mortgage lending increased by \$2m for the year ended 30 June 2019.

- Stage 1 collectively assessed: collective provisions increased \$1m due to a net increase of \$1,790m in gross balances. New lending of \$4,689m was partially offset by repayments of \$2,899m with the net lending attracting low levels of collective provisions due to very low loss rates expected in the 12 months following origination. A total of \$10m of stage 1 balances moved to stage 2 as the exposures deteriorated, which reduced stage 1 collective provisions by \$1m. However, that was balanced by \$21m of stage 2 loans showing improved credit performance after a six-month review period, allowing them to be returned to stage 1.
- Stage 2 collectively assessed: collective provisions reduced \$1m with transfers of mortgage balances into stage 2 (\$10m) being more than offset by \$21m of stage 2 mortgage lending transferring back to stage 1. Overall, there was an increase of \$19m in the total balances within this stage with new stage 2 balances and additional lending provided to existing stage 2 customers only partially offset by repayments.
- Stage 3 collectively assessed: collective provisions increased \$2m during the year due to a net increase of \$9m in stage 3 lending balances. A total of \$2m of mortgage lending was transferred into stage 3 from other stages with a net \$8m increase from additional lending to these customers or from customers more recently originated.
- Stage 3 individually assessed: specific provisions were stable over the year at \$2m, although total impaired balances reduced from \$5m to \$3m. A total of \$1m of balances were transferred from stage 3 with \$2m of lending repaid and \$1m written off.

Prior period movement in provision for credit impairment – business exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year – business exposures	4	2	1	2	9
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(2)	2	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	(1)	1	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	-	2	-	-	2
- Changes due to additions and deletions	3	1	-	-	4
- Changes due to amounts written off	-	-	-	-	-
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	3	3	-	-	6
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total (credited) to income statement for individually assessed provisions	-	-	-	(1)	(1)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of the year – business exposures	6	6	1	1	14

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross financial assets on loss allowances – business exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – business exposures					
As at beginning of the year	804	34	7	4	849
Net transfers between stages	(1)	-	(3)	4	-
Additions	642	28	-	-	670
Deletions	(343)	(10)	(2)	(6)	(361)
Amounts written off	-	-	-	-	-
Balance at end of the year – business exposures	1,102	52	2	2	1,158

Credit impairment provisions for business exposures increased a net \$5m for the year ended 30 June 2019.

- Stage 1 collectively assessed: collective provisions increased \$2m driven by a net increase of \$299m in gross balances. New lending of \$642m was partially offset by repayments of \$343m generating a \$3m charge. A total of \$2m of stage 1 collective provision reduced from exposures moved to stage 2 or stage 3 with \$1m added to stage 1 collective provision as lending was transferred back to this stage.
- Stage 2 collectively assessed: collective provisions increased \$4m from a net increase in gross balances of \$18m. A total of \$2m of the increase was due to exposures transferred from stage 1 with a \$1m reduction from exposures transferred back to stage 1. The remainder of the increase in collective provisions in that stage was due to newly originated loans and increases in stage 2 balances of \$28m, offset by repayments of \$10m. Transfers to and from stage 3 were immaterial.
- Stage 3 collectively assessed: collective provisions was stable during the year with small transfers in and out from stage 1 and 2 largely offsetting each other. Gross balances reduced from \$7m to \$2m. A total of \$4m transferred to stage 3 individually assessed provisions and \$2m was repaid, with the balance comprising \$1m of net movements from other stages and from increases in lending to these customers.
- Stage 3 individually assessed: specific provisions reduced \$1m over the year. A total of \$4m of new lending transitioned from stage 3 collectively assessed was offset by \$6m of repayments, which allowed \$1m to be written back to profit. There were no business balances written off in the year ended 30 June 2019. At 30 June 2019 total lending of \$2m was covered by \$1m of individually assessed provisions.

Notes to the financial statements continued

10. Asset quality continued

Prior period movement in provision for credit impairment – total exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
As at beginning of the year – total exposures	16	12	2	5	35
Transfers between stages:					
- Transferred to Stage 1	3	(3)	-	-	-
- Transferred to Stage 2	(4)	4	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	(1)	1	-	-	-
Charged/(credited) to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	-	3	1	-	4
- Changes due to additions and deletions	4	-	1	-	5
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	-	-	-	-	-
Total (credited) to income statement for collectively assessed provisions	4	1	2	-	7
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	(3)	(3)
Total (credited) to income statement for individually assessed provisions	-	-	-	(2)	(2)
Amounts written off from individually assessed provisions	-	-	-	-	-
Balance at end of the year – total exposures	19	14	4	3	40

Prior period impact of changes in gross financial assets on loss allowances – total exposures

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Gross carrying amount – total exposures					
As at beginning of the year - total exposures	17,567	746	17	10	18,340
Net transfers between stages	9	(12)	(2)	5	-
Additions	5,374	218	18	-	5,610
Deletions	(3,274)	(161)	(12)	(9)	(3,456)
Amounts written off	-	(10)	-	(1)	(11)
Balance at end of year – total exposures	19,676	781	21	5	20,483

Notes to the financial statements continued

10. Asset quality continued

Credit quality of financial assets neither past due nor impaired

A large portion of the credit exposures, such as residential mortgages, are secured. That is, the fair value of associated security is sufficient to ensure that the Banking Group will recover the entire amount owing over the life of the facility and there is reasonable assurance that collection efforts will result in payment of the amounts due in a timely manner.

The credit quality of loans and advances to customers that were neither past due nor impaired can be assessed by reference to the Bank's credit scoring systems. At the origination of loans and advances to customers, retail advances are assessed on a combination of debt-servicing ability, demographic characteristics and loan-to-valuation ("LVR") ratios. Non-retail advances are individually risk-graded against similar characteristics. The behavioural credit characteristics are reviewed periodically for adverse changes during the loan's life. Interest continues to be accrued on all loans. No interest has been foregone, except for certain customers with credit cards at 0% interest rates as part of Customer Care packages.

Credit quality of other financial assets

In addition to assessing impairment for loans and advances, the Banking Group has assessed impairment for cash and cash equivalents, due from other financial institutions, due from related parties, investment securities and other financial assets. All of these financial assets are considered of high credit quality and are neither past due nor impaired. The identified impairment loss for all other financial assets, excluding loans and advances, was immaterial.

Credit risk-related adjustments to financial assets at fair value

Credit impairment losses of (\$0.1m) were recognised through other comprehensive income in relation to expected credit losses on Investment Securities held at fair value through other comprehensive income in the year ended 30 June 2020 (30 June 2019: \$0.0m).

Credit Valuation Adjustments ("CVA") and Debit Valuation Adjustments ("DVA") are included in the valuations of Derivative Financial Instruments and these adjustments are recognised within net gains on financial instruments on the income statement. \$0.4m was recognised in the income statement related to CVA and DVA during the year ended 30 June 2020 (30 June 2019: \$0.3m).

Definitions

"Impaired asset" means any credit exposures against which an individually assessed provision has been recorded in accordance with NZ IFRS 9 – *Financial instruments*.

A "90-day past due asset" is any loan which has not been operated by the borrower within its key terms for at least 90 days and which is not an impaired asset.

An "asset under administration" is any credit exposure which is not an impaired asset or a past due asset, but is to a counterparty who is in receivership, liquidation, bankruptcy, statutory management or any form of administration. These are classified as "other assets under administration" and reported separately.

Notes to the financial statements continued

11. Concentration of credit risk

Concentrations of credit risk arise where the Banking Group is exposed to risk in activities or industries of a similar nature. An analysis of financial assets by industry sector at reporting date is as follows:

Dollars in millions	30/06/20			30/06/19		
	Financial assets	Off-balance sheet commitment	Total credit exposure	Financial assets	Off-balance sheet commitment	Total credit exposure
New Zealand						
Agriculture	16	4	20	20	3	23
Food and other manufacturing	164	44	208	159	34	193
Electricity, gas and water	4	8	12	5	19	24
Construction	324	240	564	289	171	460
Retail and wholesale trade	206	47	253	154	49	203
Transport and storage	137	13	150	127	9	136
Communications	21	9	30	17	14	31
Finance, investment and insurance	698	33	731	522	17	539
Property and business services	1,399	144	1,543	1,067	77	1,144
Professional, scientific and technical services	78	26	104	55	20	75
Government, local authorities and services	1,409	1	1,410	811	-	811
Education	16	3	19	17	3	20
Personal and other services	99	22	121	93	16	109
Health and community services	123	29	152	89	21	110
Households	19,693	3,195	22,888	18,369	2,949	21,318
Overseas						
Finance, investment and insurance	924	9	933	800	9	809
Total credit exposure	25,311	3,827	29,138	22,594	3,411	26,005
Less provision for credit impairment	(86)	-	(86)	(40)	-	(40)
Other financial assets	27	-	27	25	-	25
Total financial assets	25,252	3,827	29,079	22,579	3,411	25,990

Comparative prior period amounts in the table above for the year ended 30 June 2019 have been reclassified to align with the classifications used in the current period's presentation and off-balance sheet commitments have been added to provide more meaningful information to users.

Australian and New Zealand Standard Industrial Classification ("ANZSIC") codes have been used as the basis for disclosing customer industry sectors in the above table.

Notes to the financial statements continued

11. Concentration of credit risk continued

Maximum exposure to credit risk and collateral held

Dollars in millions	30/06/2020				
	Financial assets	Off-balance sheet commitments	Maximum exposure to credit risk	Collateral	Net credit exposure
Credit risk relating to on-balance sheet assets					
Loans and advances	22,308	-	22,308	(21,906)	402
Due from other financial institutions	105	-	105	-	105
Due from related parties	77	-	77	-	77
Derivative financial instruments	434	-	434	(105)	329
Investment securities	1,895	-	1,895	-	1,895
Cash and cash equivalents	492	-	492	-	492
Other financial assets	27	-	27	-	27
Total on-balance sheet credit risk	25,338	-	25,338	(22,011)	3,327
Less provision for credit impairment	(86)	-	(86)	-	(86)
Total financial assets	25,252	-	25,252	(22,011)	3,241
Credit risk relating to off-balance sheet commitments					
Undrawn credit commitments	-	3,827	3,827	-	3,827
Total off-balance sheet credit risk	-	3,827	3,827	-	3,827
Total credit risk	25,252	3,827	29,079	(22,011)	7,068

Dollars in millions	30/06/2019				
	Financial assets	Off-balance sheet commitments	Maximum exposure to credit risk	Collateral	Net credit exposure
Credit risk relating to on-balance sheet assets					
Loans and advances	20,483	-	20,483	(20,069)	414
Due from other financial institutions	71	-	71	-	71
Due from related parties	85	-	85	-	85
Derivative financial instruments	358	-	358	(69)	289
Investment securities	1,176	-	1,176	-	1,176
Cash and cash equivalents	421	-	421	-	421
Other financial assets	25	-	25	-	25
Total on-balance sheet credit risk	22,619	-	22,619	(20,138)	2,481
Less provision for credit impairment	(40)	-	(40)	-	(40)
Total financial assets	22,579	-	22,579	(20,138)	2,441
Credit risk relating to off-balance sheet commitments					
Undrawn credit commitments	-	3,411	3,411	-	3,411
Total off-balance sheet credit risk	-	3,411	3,411	-	3,411
Total credit risk	22,579	3,411	25,990	(20,138)	5,852

Comparative prior period amounts in the table above for the year ended 30 June 2019 have been reclassified to align with the classifications used in the current period's presentation and to add off-balance sheet commitments.

The table above represents the maximum net credit risk exposure of the Banking Group at 30 June 2020. The exposures set out are based on net carrying amounts as reported in the balance sheet.

Notes to the financial statements continued

11. Concentration of credit risk continued

The exposure of the Banking Group derived from loans and advances to retail and corporate customers is 88% of the total maximum exposure at 30 June 2020 (30 June 2019: 91%).

The table on the prior page provides a quantification of the value of the financial charges the Banking Group holds over a borrower's specific asset (or assets) where the Banking Group is able to enforce the collateral in satisfying the debt in the event of the borrower failing to meet its contractual obligations. For the purposes of this disclosure, where collateral held is valued at more than the corresponding credit exposure, coverage is capped at the value of the credit exposure less amounts for which an individually assessed provision for credit impairment has been recognised. The most common type of collateral is over real estate including residential, commercial, industrial and rural property.

12. Concentration of credit exposures to counterparties

CREDIT EXPOSURE TO INDIVIDUAL COUNTERPARTIES

Credit exposure concentrations to individual counterparties at the reporting date are disclosed on the basis of actual credit exposures. Peak end-of-day aggregate credit exposures are disclosed on the basis of actual credit exposures and have been calculated gross of set-offs using the Banking Group's common equity tier 1 capital ("CET1 capital") at the end of the period.

The individual counterparty exposures included in the following table exclude 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
- any supranational or quasi-sovereign agency with a long-term credit rating of A- or A3 or above, or its equivalent.

	As at 30/06/20	Peak end-of-day for the 6 months ended 30/06/20
Exposures to banks		
Total number of exposures to banks that are greater than 10% of CET1 capital	1	3
With a long-term credit rating of A- or A3 or above, or its equivalent	1	3
- 10% to less than 15% of CET1 capital	1	1
- 15% to less than 20% of CET1 capital	-	1
- 20% to less than 25% of CET1 capital	-	1
- 25% to less than 30% of CET1 capital	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-
Exposures to non-banks		
Total number of exposures to non-banks that are greater than 10% of CET1 capital	-	-
With a long-term credit rating of A- or A3 or above, or its equivalent	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-

Notes to the financial statements continued

12. Concentration of credit exposures to counterparties continued

Prior period disclosure of credit exposures to individual counterparties

The Banking Group incorrectly excluded exposures to banks in prior period disclosures of credit exposures to individual counterparties. The disclosure error was made in the June 2018, December 2018 and June 2019 Disclosure Statements. The comparative period disclosures for June 2019 have been included below.

	As at 30/06/19	Peak end-of-day for the 6 months ended 30/06/19
Exposures to banks		
Total number of exposures to banks that are greater than 10% of CET1 capital	-	3
With a long-term credit rating of A- or A3 or above, or its equivalent	-	3
- 10% to less than 15% of CET1 capital	-	1
- 15% to less than 20% of CET1 capital	-	2
- 20% to less than 25% of CET1 capital	-	-
- 25% to less than 30% of CET1 capital	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-
Exposures to non-banks		
Total number of exposures to non-banks that are greater than 10% of CET1 capital	-	-
With a long-term credit rating of A- or A3 or above, or its equivalent	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-

CREDIT EXPOSURES TO CONNECTED PERSONS

The Banking Group's credit exposure to connected persons has been derived in accordance with its conditions of registration and the RBNZ's Connected Exposures Policy (BS8), is net of individually assessed credit impairment provisions and excludes advances to connected persons of a capital nature.

The Banking Group does not have credit exposures to connected persons other than non-bank connected persons. Peak end-of-day credit exposures to non-bank connected persons have been calculated using the Banking Group's Tier 1 capital at the end of the year. The rating-contingent limit, which is applicable to the Banking Group as at the reporting date, is 60%. There have been no rating-contingent limit changes during the past year. Within the rating-contingent limit there is a sub-limit of 15% of the Banking Group's Tier 1 capital, which applies to non-bank connected persons.

All limits on aggregate credit exposure to all connected persons and non-bank connected persons in the Banking Group's conditions of registration have been complied with at all times over the past year. The limit is 125% of the Banking Group's Tier 1 capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

There are no individual impairment credit allowances against credit exposures to non-bank connected persons nor are there any contingent exposures arising from risk lay-off arrangements to connected persons as at 30 June 2020 (30 June 2019: nil).

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Credit exposures to non-bank connected persons at year-end	77	88
Credit exposures to non-bank connected persons at year-end as a percentage of Tier 1 capital	4.6%	5.4%
Peak credit exposures to non-bank connected persons during the year	97	88
Peak credit exposures to non-bank connected persons during the year as a percentage of Tier 1 capital	5.8%	5.4%

Notes to the financial statements continued

13. Cash and cash equivalents



Accounting policy

Cash and cash equivalents is considered to include notes and coins on hand, current accounts in banks, ATMs, overnight bank deposits, net of bank overdrafts and inter-bank balances arising from the daily RBNZ settlement process, with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value, and are used by the Banking Group in the management of its short-term commitments.

Cash and cash equivalents are measured at amortised cost on the balance sheet.

Dollars in millions	30/06/20	30/06/19
Cash in hand	62	38
Cash with central bank	360	311
Call and overnight advances to financial institutions	70	72
Total cash and cash equivalents – current	492	421

14. Due from other financial institutions



Accounting policy

Balances due from other financial institutions are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method. Interest, ECL and reversals and foreign exchange gains and losses are recognised in the income statement.

Reverse repurchase agreements

The Banking Group purchases (a reverse repurchase agreement) or borrows collateral in the form of securities and provides cash in exchange. The Banking Group may sell or re-pledge any collateral received, but has an obligation to return the collateral at the maturity of the contract and the counterparty retains substantially all the risks and rewards of ownership. Consequently the collateral is not recognised by the Banking Group, which instead records a receivable for the cash provided. The difference between the purchase and sale price of the collateral represents interest income and is recognised in the income statement over the term of the reverse repurchase agreement.

Dollars in millions	30/06/20	30/06/19
Collateral paid	105	71
Total amounts due from other financial institutions – current	105	71

Included within the above balance is \$105.0m of collateral pledged by Kiwibank in respect of its credit support annex obligations to derivative counterparties (2019: \$70.6m).

15. Investment securities



Accounting policy

Investment securities are debt securities measured at fair value through other comprehensive income (“FVOCI”). Gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost: any interest calculated using the effective interest method; ECL and reversals; and foreign exchange gains and losses. On derecognition, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the income statement; see net gains on financial instruments (note 4).

The accounting policy for the calculation of ECL is outlined in credit impairment losses (note 9).

Notes to the financial statements continued

15. Investment securities continued

Dollars in millions	30/06/20	30/06/19
Government stock and multilateral development banks	1,301	869
Treasury bills	75	-
Local authority securities	95	-
Other debt securities	424	307
Total investment securities – current	1,895	1,176

16. Derivative financial instruments and hedging activities



Accounting policy

The Banking Group uses derivatives as part of its asset and liability management activities to manage exposures to interest rate and foreign currency, including exposures arising from forecast transactions. These derivatives include swaps, futures, forwards, options and other contingent or exchange-traded contracts in the interest rate and foreign exchange markets.

Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are presented as assets when fair value is positive and as liabilities when fair value is negative.

The method of recognising the resulting fair value gain or loss depends on the nature of the item being hedged. The Banking Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or firm commitments (a “**fair value hedge**”); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction (a “**cash flow hedge**”). Hedge accounting is used for derivatives designated in this way, provided that certain criteria are met.

The Banking Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Banking Group also documents 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 values or cash flows of hedged items.

As permitted by NZ IFRS 9, the Banking Group has elected to continue to apply the hedge accounting requirements of NZ IAS 39.

Fair value hedge

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

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

Cash flow hedge

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

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

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 equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives held for trading

Certain derivative instruments do not qualify for hedge accounting. These include derivatives transacted as part of the trading activity of the Banking Group, as well as derivatives transacted as economic hedges but not qualifying for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement.

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

The Banking Group uses the following derivative instruments for both hedging and non-hedging purposes:

- Currency forwards represent commitments to purchase domestic and foreign currency, including undelivered spot transactions.
- Foreign currency and interest rate futures are contractual obligations to receive or pay a net amount based on changes in currency rates or interest rates, or to buy or sell foreign currency or a financial instrument on a future date at a specified price, established in an organised financial market. The credit risk is negligible, as futures contracts are collateralised by cash or marketable securities, and changes in the futures' contract value are settled daily with the exchange.
- Forward rate agreements are individually negotiated interest rate futures that call for a cash settlement at a future date for the difference between a contracted rate of interest and the current market rate, based on a notional principal amount.
- Currency and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies or interest rates (e.g. fixed rate for floating rate) or a combination of all these (i.e. cross-currency interest rate swaps). No exchange of principal takes place, except for certain currency swaps. The Banking Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to fulfil their obligation. This risk is monitored on an ongoing basis with reference to the current fair value. To control the level of credit risk taken, the Banking Group assesses counterparties using the same techniques as for its lending activities.
- Foreign currency and interest rate options are contractual agreements under which the seller (writer) grants the purchaser (holder) the right, but not the obligation, either to buy (a call option) or sell (a put option) at or by a set date or during a set period, a specific amount of a foreign currency or a financial instrument at a predetermined price. The seller receives a premium from the purchaser in consideration for the assumption of foreign exchange or interest rate risk. Options may be either exchange-traded or negotiated between the Banking Group and a customer over the counter. The Banking Group is exposed to credit risk on purchased options only and only to the extent of their carrying amount, which is their fair value.
- The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Banking Group's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand and the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time. The fair value of derivative instruments is set out below.

Dollars in millions	30/06/20			30/06/19		
	Notional principal amount	Fair values		Notional principal amount	Fair values	
		Assets	Liabilities		Assets	Liabilities
Derivatives held for trading						
Foreign exchange derivatives	587	6	(7)	641	4	(5)
Interest rate derivatives	12,150	257	(257)	16,791	252	(257)
Total derivatives held for trading	12,737	263	(264)	17,432	256	(262)
Derivatives held for hedging						
Designated as cash flow hedges						
Interest rate derivatives	10,366	55	(132)	11,941	36	(75)
Exchange rate derivatives	836	109	(4)	815	63	(6)
Total derivatives designated as cash flow hedges	11,202	164	(136)	12,756	99	(81)
Designated as fair value hedges						
Interest rate derivatives	200	7	-	150	3	-
Total derivatives designated as fair value hedges	200	7	-	150	3	-
Total derivatives held for hedging	11,402	171	(136)	12,906	102	(81)
Total derivative financial instruments	24,139	434	(400)	30,338	358	(343)
Current		78	(81)		58	(73)
Non-current		356	(319)		300	(270)

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

Derivatives held for hedging

INTEREST RATE DERIVATIVES

The Banking Group's approach to managing market risk, including interest rate risk, is discussed in note 33. The Banking Group hedges benchmark interest rate risk. Hedge accounting is applied where economic hedge relationships meet the hedge accounting criteria.

Before hedge accounting is applied by the Banking Group, the Banking Group determines whether an economic relationship between the hedged item and the hedging instrument exists based on an evaluation of the qualitative characteristics of these items and the hedged risk that is supported by quantitative analysis. The Banking Group considers whether the critical terms of the hedged item and hedging instrument closely align when assessing the presence of an economic relationship. The Banking Group evaluates whether the fair value of the hedged item and the hedging instrument respond similarly to similar risks.

The Banking Group establishes a hedge ratio by aligning the par amount of the exposure to be hedged and the notional amount of the interest rate swap designated as a hedging instrument. The hedge relationship is reviewed on a monthly basis and the hedging instruments and hedged items are de-designated and re-designated, if necessary, based on the effectiveness test results and changes in the hedged exposure.

Hedge accounting strategies:

- Micro fair value hedge accounting is applied to receive fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate subordinated debt issuances and medium-term notes.
- Micro fair value hedge accounting is applied to pay fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate investment securities.
- In fair value hedging, the designated hedging relationships result in fair value gains and losses on the hedged item and derivative being recorded through the income statement as incurred. When a fair value hedging relationship is de-designated, the fair value adjustments to the balance sheet carrying value are amortised to the income statement over the remaining period to the maturity date of the de-designated hedge.
- Portfolio (macro) cash flow hedge accounting is applied to interest rate swaps designated as hedges of the Banking Group's portfolios of floating-rate customer loans and deposits. The effective portion of the fair value gains and losses on the hedging instrument is initially recognised directly in other comprehensive income ("OCI") within equity (cash flow hedge reserve). The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in 'net gains on financial instruments' in the income statement.
- When a cash flow hedging instrument expires, is sold, terminated, or when a hedge no longer meets the criteria for cash flow hedge accounting, any cumulative gain or loss that has been recognised in OCI at that time remains in OCI and is recognised when the hedged forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in OCI is immediately transferred to the income statement.

For all hedge strategies, ineffectiveness arises from the following sources:

- differences in timing of cash flows of hedged items and hedging instruments;
- different interest rate curves applied to discount the hedged items and hedging instruments; and
- the effect of changes in counterparties' credit risk on the fair values of hedging instruments.

INTEREST AND FOREIGN EXCHANGE DERIVATIVES

The Banking Group's approach to managing market risk, including interest rate and foreign exchange risk, is discussed in note 33.

The interest and foreign currency risk arising from the Bank's foreign currency debt issues is hedged using cross-currency swaps. The foreign currency legs of the cross-currency swaps match the critical terms of the hedged debt issues, creating economic hedge relationships that meet hedge accounting criteria.

These are designated as either cash flow or both fair value and cash flow hedges (split designation) to manage the different components of foreign currency and interest rate risk:

- fair value hedge relationship where cross-currency swaps are used to manage the interest rate and foreign currency risk in relation to foreign-currency-denominated borrowing with fixed interest rates.
- cash flow hedge relationship where cross-currency swaps are used to manage the variability in cash flows arising from interest rate movements on floating interest rate payments and foreign exchange movements on payment of principal and interest.

Ineffectiveness arises from the following sources:

- differences in timing of cash flows of hedged items and hedging instruments;
- different interest rate curves applied to discount the hedged items and hedging instruments; and
- the effect of changes in counterparties' credit risk on the fair values of hedging instruments.

Similar to the hedge relationships under interest rate risk, the ineffective portion of the gain or loss on the hedging instrument is recognised immediately in 'net gains in financial instruments' in the income statement.

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

The following table shows the maturity and interest rate risk profiles of the interest rate swaps as hedging instruments in continuing fair value and cash flow hedge relationships.

Dollars in millions	30/06/20				Total
	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	
Interest rate risk					
Cash flow hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	863	4,179	4,110	-	9,152
Average interest rate	2.14%	1.66%	1.07%	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	-	141	1,073	-	1,214
Average interest rate	-	2.57%	1.90%	-	
Fair value hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	-	-	200	-	200
Average interest rate	-	-	1.08%	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	-	-	-	-	-
Average interest rate	-	-	-	-	
Total interest rate risk nominal amounts	863	4,320	5,383	-	10,566
Interest rate and foreign exchange risk					
Cash flow hedge relationships					
Cross-currency swaps (HKD: NZD)					
Nominal amounts	-	-	110	-	110
Average HKD-NZD exchange rate	-	-	5.49	-	
Average interest rate	-	-	float	-	
Cross-currency swaps (USD: NZD)					
Nominal amounts	-	-	-	-	-
Average USD-NZD exchange rate	-	-	-	-	
Average interest rate	-	-	-	-	
Fair value and cash flow hedge relationships					
Cross-currency swaps (CHF: NZD)					
Nominal amounts	-	245	245	-	490
Average CHF-NZD exchange rate	-	0.78	0.69	-	
Average interest rate	-	1.01%	0.26%	-	
Cross-currency swaps (AUD: NZD)					
Nominal amounts	-	43	32	161	236
Average AUD-NZD exchange rate	-	0.90	0.78	0.89	
Average interest rate	-	3.47%	5.52%	4.25%	
Total interest rate and foreign exchange risk nominal amounts	-	288	387	161	836
Total nominal amounts	863	4,608	5,770	161	11,402

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

Dollars in millions	30/06/19				Total
	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	
Interest rate risk					
Cash flow hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	1,376	3,098	4,833	-	9,307
Average interest rate	2.08%	2.29%	1.85%	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	45	1,664	925	-	2,634
Average interest rate	2.32%	2.08%	2.28%	-	
Fair value hedge relationships					
<i>Pay fixed</i>					
Interest rate swaps					
Nominal amounts	-	50	-	-	50
Average interest rate	-	4.65%	-	-	
<i>Receive fixed</i>					
Interest rate swaps					
Nominal amounts	100	-	-	-	100
Average interest rate	4.50%	-	-	-	
Total interest rate risk nominal amounts	1,521	4,812	5,758	-	12,091
Interest rate and foreign exchange risk					
Cash flow hedge relationships					
Cross-currency swaps (HKD: NZD)					
Nominal amounts	-	-	104	-	104
Average HKD-NZD exchange rate	-	-	5.49	-	
Average interest rate	-	-	float	-	
Cross-currency swaps (USD: NZD)					
Nominal amounts	-	22	-	-	22
Average USD-NZD exchange rate	-	0.79	-	-	
Average interest rate	-	float	-	-	
Fair value and cash flow hedge relationships					
Cross-currency swaps (CHF: NZD)					
Nominal amounts	-	-	459	-	459
Average CHF-NZD exchange rate	-	-	0.74	-	
Average interest rate	-	-	0.64%	-	
Cross-currency swaps (AUD: NZD)					
Nominal amounts	-	-	73	157	230
Average AUD-NZD exchange rate	-	-	0.85	0.89	
Average interest rate	-	-	4.35%	4.25%	
Total interest rate and foreign exchange risk nominal amounts	-	22	636	157	815
Total nominal amounts	1,521	4,834	6,394	157	12,906

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

The following table sets out the accumulated fair value adjustments arising from the corresponding continuing fair value hedge relationships and the outcome of the changes in fair value of the hedge item as well as the hedging instruments used as the basis for recognising ineffectiveness.

Dollars in millions	30/06/20		Year ended 30/06/20
	Carrying value	Accumulated amount of fair value hedge adjustments	Gains/(losses) on fair value attributable to hedged risk used for recognising hedge ineffectiveness
Interest rate risk			
Debt securities issued	(207)	(7)	-
Interest rate swaps	7	7	-
Interest rate risk and foreign currency risk			
Debt securities issued	(1,066)	(38)	(5)
Cross-currency swaps	105	37	5
Total ineffectiveness of financial instruments in fair value hedge relationship			-

Dollars in millions	30/06/19		Year ended 30/06/19
	Carrying value	Accumulated amount of fair value hedge adjustments	Gains/(losses) on fair value attributable to hedged risk used for recognising hedge ineffectiveness
Interest rate risk			
Debt securities issued	(151)	(1)	2
Interest rate swaps	3	1	(2)
Interest rate risk and foreign currency risk			
Debt securities issued	(1,005)	(33)	(20)
Cross-currency swaps	57	32	20
Total ineffectiveness of financial instruments in fair value hedge relationship			-

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for any hedged items that have ceased to be adjusted for hedging gains and losses is nil.

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

The table below sets out the notional and carrying amounts of the derivatives the Banking Group uses as hedging instruments in continuing cash flow hedge relationships and the changes in fair values used for measuring hedge ineffectiveness, showing separately the effective and ineffective portions:

Dollars in millions	Interest rate risk		Interest and foreign currency risk	Total
	Interest rate swaps		Cross-currency swaps	
As at 30/06/20				
Notional amount	10,366		836	11,202
Carrying amount:				
Assets	55		109	164
Liabilities	(132)		(4)	(136)
Changes in fair value of hedging instruments used for measuring hedge ineffectiveness:				
Hedged item	77		(68)	9
Hedging instrument	(77)		68	(9)
Year ended 30/06/20	Recognised in/ reclassified to:			
Effective portion	OCI ¹	(33)	3	(30)
Hedge ineffectiveness	Net gains on FI ²	-	-	-
Reclassified into income statement as:	Interest (expense)/income	(5)	(14)	(19)
	Net gains on FI ²	-	39	39

¹ Other comprehensive income

² Net gains on financial instruments

Dollars in millions	Interest rate risk		Interest and foreign currency risk	Total
	Interest rate swaps		Cross-currency swaps	
As at 30/06/19				
Notional amount	11,941		815	12,756
Carrying amount:				
Assets	36		63	99
Liabilities	(75)		(6)	(81)
Changes in fair value of hedging instruments used for measuring hedge ineffectiveness:				
Hedged item	39		(26)	13
Hedging instrument	(39)		26	(13)
Year ended 30/06/19	Recognised in / reclassified to:			
Effective portion	OCI ¹	(16)	(1)	(17)
Hedge ineffectiveness	Net gains on FI ²	-	-	-
Reclassified into income statement as:	Interest (expense)/income	(4)	14	10
	Net gains on FI ²	-	(20)	(20)

¹ Other comprehensive income

² Net gains on financial instruments

Notes to the financial statements continued

17. Due to other financial institutions



Accounting policy

Amounts due to other financial institutions are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Repurchase agreements

Under repurchase agreements, collateral in the form of securities is advanced to a third party and the Banking Group receives cash in exchange. The counterparty is allowed to sell or re-pledge the collateral advanced under repurchase agreements in the absence of default by the Banking Group, but they have an obligation to return the collateral at the maturity of the contract. The Banking Group has determined that it retains substantially all the risks and rewards of the securities advanced and therefore they are not derecognised and are retained within the relevant security portfolio and accounted for accordingly. Liability accounts are used to record the obligation to repurchase. The difference between the sale and repurchase price represents interest expense and is recognised in the income statement over the term of the repurchase agreement.

Dollars in millions	30/06/20	30/06/19
Cash collateral received	105	69
Transaction balances with other financial institutions	10	57
Repurchase agreements	202	-
Total amounts due to other financial institutions – current	317	126

18. Deposits and other borrowings



Accounting policy

Deposits and other borrowings are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Dollars in millions	30/06/20	30/06/19
Demand deposits non-interest bearing	3,353	2,314
Demand deposits bearing interest	4,466	3,498
Term deposits	12,778	12,428
Total deposits and other borrowings	20,597	18,240
Current	20,197	17,625
Non-current	400	615

In the event of the liquidation of Kiwibank, deposit holders will rank equally with all other creditors but ahead of subordinated debt holders and the shareholder. In addition, all payment obligations of Kiwibank covered by the NZP Guarantee that existed at the time the NZP Guarantee was terminated on 28 February 2017 are guaranteed under the NZP Guarantee but only in relation to and to the extent of those obligations.

The Kiwibank PIE Unit Trust (the “**Trust**”), established in May 2008, operates three funds: the PIE Term Deposit Fund, the Notice Saver and PIE Online Call Fund. Kiwibank Investment Management Limited is the issuer and manager (the “**Manager**”), Trustees Executors Limited is the Supervisor and Kiwibank is the promoter of the Trust. Units in the Trust do not directly represent deposits or liabilities of Kiwibank; however, the Trust is invested exclusively in term and call deposits with Kiwibank. At 30 June 2020, \$4,707m of the Trust’s funds were invested in Kiwibank products or securities (30 June 2019: \$4,438m).

Kiwibank guarantees the payment obligations of the Manager and any amounts owing to Unit holders under the Trust Deed in respect of their units. Kiwibank agrees to pay to Unit holders any shortfall between the amount they may receive on redeeming their units or in the winding up of the Trust and the balance of their unit accounts.

Notes to the financial statements continued

19. Debt securities issued



Accounting policy

Debt securities issued, with the exception of Commercial paper, are measured at amortised cost. Commercial paper is measured at fair value through profit or loss. Debt securities measured at amortised cost are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Commercial paper is designated as a financial liability as at fair value through profit or loss ("FVTPL"), and consists of European Commercial Paper ("ECP"). ECP is measured at fair value with any realised and unrealised gains or losses recognised in the income statement. ECP issued has been designated at fair value through profit or loss as the Banking Group holds related derivatives at fair value through profit or loss, and the designation therefore eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The amount of change in the fair value of the liability that is attributable to changes in its credit risk would be presented in other comprehensive income ("OCI") as part of the fair value reserve. Amounts presented in the fair value reserve are not subsequently transferred to profit or loss. When these instruments are derecognised, the related cumulative amount in the fair value reserve is transferred to retained earnings.

Dollars in millions	30/06/20	30/06/19
Short-term debt		
Certificates of deposit	479	495
Long-term debt		
Medium-term notes	1,460	1,319
Covered bonds	246	230
Fair value hedge adjustment	44	34
Total debt securities issued	2,229	2,078
Current	769	878
Non-current	1,460	1,200

In the event of the liquidation of Kiwibank, holders of these debt securities, with the exception of covered bonds, will rank equally with all other creditors but ahead of subordinated debt holders and the shareholder. In addition, all payment obligations of Kiwibank that existed at the time the NZP Guarantee was terminated on 28 February 2017, excluding any payment obligations, the terms of which expressly provide that they do not have the benefit of the guarantee, are guaranteed under the NZP Guarantee but only in relation to and to the extent of those obligations.

The guarantee arrangements and other details relating to covered bonds are disclosed in note 24.

Kiwibank has not had any defaults of principal, interest or other breaches with respect to debt securities issued during the year (year ended 30 June 2019: nil).

Reconciliation of movement in liability arising from financing activities

Dollars in millions	30/06/20	30/06/19
Opening balance	2,078	2,265
Issuances	1,627	1,102
Repayments	(1,537)	(1,325)
Total cash movements	90	(223)
Effect of changes in foreign exchange rates	43	9
Fair value and other movements	18	27
Closing balance	2,229	2,078

The comparative prior period amounts have been reclassified to align with the categories used in the current period's presentation.

Notes to the financial statements continued

20. Subordinated debt



Accounting policy

Subordinated debt issues are initially measured at fair value minus incremental direct transaction costs, and subsequently measured at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement, as is any gain or loss when the liability is derecognised.

Dollars in millions	30/06/20	30/06/19
Convertible subordinated bonds	-	104
Perpetual capital bonds	150	149
Total subordinated debt	150	253
Current	-	104
Non-current	150	149

The Banking Group has not issued any subordinated debt during the year ended 30 June 2020 (year ended 30 June 2019: nil). On 15 July 2019, Kiwibank fully repaid \$100m of convertible subordinated bonds at the first call date (year ended 30 June 2019: nil).

The Banking Group has not had any defaults of principal, interest or other breaches with respect to these liabilities during the year (year ended 30 June 2019: nil).

As at 30 June 2020, nil subordinated debt qualified as Tier 2 capital for Capital Adequacy calculation purposes (30 June 2019: \$100m). As at 30 June 2020, \$150m of subordinated debt qualified as Additional Tier 1 capital for Capital Adequacy calculation purposes (30 June 2019: \$149m). The contractual terms of subordinated debt instruments on issue expressly provide that they do not have the benefit of a deed poll guarantee (the "NZZ Guarantee") provided by NZP. The NZP Guarantee was terminated with an effective date of 28 February 2017.

The subordinated debt instruments on issue are subordinate to all other general liabilities of the Banking Group and are denominated in New Zealand dollars.

The key terms and conditions of the subordinated debt instruments on issue are as follows:

Instrument	Issue date	Amount (\$m)	Coupon rate	Next reset date	Maturity date
Perpetual capital bonds	27 May 2015	150	3.985% p.a. ¹	27 May 2025	None

¹Fixed interest rate was reset on 27 May 2020 from 7.25% to 3.985% and will be reset at five-yearly intervals thereafter.

The perpetual capital bonds have no maturity date; however, Kiwibank may elect to make an early repayment on 27 May 2025 after obtaining the consent of the RBNZ. The classification of perpetual capital bonds as non-current is based on the instruments having no contractual maturity date, and the Banking Group is not contractually obliged to make any early repayment, and early repayment is subject to the RBNZ's consent being obtained prior to repayment.

Reconciliation of movement in liability arising from financing activities

Dollars in millions	30/06/20	30/06/19
Opening balance	253	254
Issuances	-	-
Repayments	(100)	-
Interest paid	(3)	(7)
Total cash movements	(103)	(7)
Effect of changes in foreign exchange rates	-	-
Interest accrued	-	7
Fair value and other movements	-	(1)
Closing balance	150	253

Notes to the financial statements continued

21. Concentration of funding

Concentrations of funding arise where the Banking Group is funded by industries of a similar nature or in particular geographies. ANZSIC codes have been used as the basis for disclosing industry sectors. An analysis of financial liabilities by industry sector and geography at the reporting date is as follows:

Dollars in millions	30/06/20	30/06/19
New Zealand		
Agriculture	41	41
Food and other manufacturing	302	181
Electricity, gas and water	20	31
Construction	284	180
Retail and wholesale trade	151	80
Transport and storage	60	152
Communications	33	33
Finance, investment and insurance	3,603	3,469
Property and business services	300	270
Professional, scientific and technical services	258	186
Government, local authorities and services	219	250
Education	227	200
Personal and other services	233	190
Health and community services	235	236
Households	16,329	14,246
Overseas		
Finance, investment and insurance	1,055	956
Households	342	311
Other	8	37
Total funding	23,700	21,049
Lease liabilities	97	-
Other financial liabilities	70	63
Total financial liabilities	23,867	21,112

The comparative prior period amounts in the table above for the year ended 30 June 2019 have been reclassified to align with the categories used in the current period's presentation to provide more meaningful information to users.

Notes to the financial statements continued

22. Financial instruments



Accounting policy

The Banking Group measures certain financial instruments at fair value at each reporting date. In addition, the fair values of certain financial instruments which are measured at amortised cost are disclosed.

Fair value is the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants at the reporting date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The Banking Group must have access to the principal or the most advantageous market.

The fair value of an asset or liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their own economic best interest.

The Banking Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy based on the lowest level input that is significant to the fair value measurement as a whole.

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Banking Group determines whether any transfers between levels in the hierarchy have occurred by reassessing categorisation at the end of each reporting period.



Critical accounting estimates and judgements

The fair value of financial instruments that are not quoted in an active market is determined by using valuation techniques. Management use a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Where unobservable market data is used, more judgement is required to determine fair value. The valuation methodologies are described further within this note.

The term “financial instruments” includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants, at the reporting date, in the principal, or in its absence, the most advantageous market to which the Banking Group has access (at that date).

a) Measurement basis of financial assets and liabilities

The accounting policies describe how different classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the carrying amounts of the financial assets and liabilities by category and by balance sheet heading.

Dollars in millions	30/06/20					Total
	Amortised cost	FVOCI	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	
Cash and cash equivalents	492	-	-	-	-	492
Due from other financial institutions	105	-	-	-	-	105
Investment securities	-	1,895	-	-	-	1,895
Loans and advances	22,222	-	-	-	-	22,222
Derivative financial instruments	-	-	263	-	171	434
Due from related parties	77	-	-	-	-	77
Other financial assets	25	-	-	2	-	27
Total financial assets	22,921	1,895	263	2	171	25,252

Notes to the financial statements continued

22. Financial instruments continued

Dollars in millions	30/06/20				Total
	Amortised cost	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	
Due to other financial institutions	317	-	-	-	317
Deposits and other borrowings	20,597	-	-	-	20,597
Derivative financial instruments	-	264	-	136	400
Debt securities issued	2,229	-	-	-	2,229
Subordinated debt	150	-	-	-	150
Due to related parties	7	-	-	-	7
Lease liabilities	97	-	-	-	97
Other financial liabilities	70	-	-	-	70
Total financial liabilities	23,467	264	-	136	23,867

Dollars in millions	30/06/19					Total
	Amortised cost	FVOCI	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	
Cash and cash equivalents	421	-	-	-	-	421
Due from other financial institutions	71	-	-	-	-	71
Investment securities	-	1,176	-	-	-	1,176
Loans and advances	20,443	-	-	-	-	20,443
Derivative financial instruments	-	-	256	-	102	358
Due from related parties	85	-	-	-	-	85
Other financial assets	25	-	-	-	-	25
Total financial assets	21,045	1,176	256	-	102	22,579

Dollars in millions	30/06/19				Total
	Amortised cost	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	
Due to other financial institutions	126	-	-	-	126
Deposits and other borrowings	18,240	-	-	-	18,240
Derivative financial instruments	-	262	-	81	343
Debt securities issued	2,078	-	-	-	2,078
Subordinated debt	253	-	-	-	253
Due to related parties	9	-	-	-	9
Other financial liabilities	63	-	-	-	63
Total financial liabilities	20,769	262	-	81	21,112

Notes to the financial statements continued

22. Financial instruments continued

b) Fair values of financial assets and liabilities

The following tables summarise the carrying values of financial assets and liabilities presented on the Banking Group's balance sheet. The fair values presented in the tables are at a specific date and may be significantly different from the amounts which will actually be paid or received on the maturity or settlement date.

Dollars in millions	30/06/20		30/06/19	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets				
Investment securities	1,895	1,895	1,176	1,176
Loans and advances	22,222	22,313	20,443	20,481
Derivative financial instruments	434	434	358	358
Due from related parties	77	77	85	85
Financial liabilities				
Deposits and other borrowings	20,597	20,628	18,240	18,264
Derivative financial instruments	400	400	343	343
Debt securities issued	2,229	2,239	2,078	2,090
Subordinated debt	150	154	253	260
Due to related parties	7	7	9	9

The carrying values of the following financial instruments are a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently: cash and cash equivalents, due from other financial institutions, other financial assets, due to other financial institutions and other financial liabilities. No fair value disclosures are required for lease liabilities; therefore, they are excluded from the table above.

c) Fair value measurement

Assets and liabilities carried at fair value or for which fair values are disclosed have been classified into three levels according to the quality and reliability of information used to determine the fair values. The three levels of the fair value hierarchy are defined as follows:

Level 1 – Fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Fair value measurements are those where quoted market prices are not available, e.g. where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3 – Fair value measurements where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

Unless otherwise noted, the following disclosures are provided separately for assets and liabilities at fair value and those carried at amortised cost.

There have been no transfers between levels 1 and 2 during the year (year ended 30 June 2019: no transfers). There were also no transfers into/out of level 3 during the year (year ended 30 June 2019: no transfers).

Notes to the financial statements continued

22. Financial instruments continued

d) Financial assets and liabilities carried at fair value

Valuation methodology

The fair values of assets and liabilities carried at fair value were determined by application of the following methods and assumptions.

Investment securities

Estimates of fair value for investment securities are based on quoted market prices or determined using market-accepted valuation models as appropriate (including discounted cash flow models) with inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Other financial assets

Other financial assets that are classified at fair value through profit or loss includes secured convertible notes. The notes provide the right to convert to equity and to the underlying software assets as security in the event of default. The carrying amount of the note is supported primarily by the replacement cost of the software asset based on independent estimates.

Debt securities issued

Debt securities issued that are classified at fair value through profit or loss are short term in nature. For these liabilities, fair value has been determined using a discounted cash flow model with inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Derivative financial instruments

Where the Banking Group's derivative financial assets and liabilities are not traded on an exchange, they are valued using valuation techniques, including discounted cash flow and option pricing models, as appropriate. The types of derivatives classified as level 2 and the valuation techniques used include:

- interest rate swaps which are valued using discounted cash flow models; the most significant inputs into those models are interest rate yield curves which are developed from quoted rates; and
- foreign exchange derivatives that do not contain options which are priced using rates available from publicly quoted sources.

Dollars in millions	30/06/20				30/06/19			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	-	434	-	434	-	358	-	358
Investment securities	792	1,103	-	1,895	475	701	-	1,176
Other financial assets	-	-	2	2	-	-	-	-
Financial liabilities at fair value								
Derivative financial liabilities	-	400	-	400	-	343	-	343

e) Financial assets and liabilities carried at amortised cost

Valuation methodology

The fair values of assets and liabilities carried at amortised cost were determined by application of the following methods and assumptions.

Loans and advances

The Banking Group provides loans and advances to corporate and retail customers at both fixed and variable rates. The carrying value of the variable rate loans and advances is assumed to be their fair value. For fixed-rate lending, several techniques are used to estimate fair value taking into account expected credit losses, prevailing market interest rates and expected future cash flows. For retail exposures, fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Banking Group and other financial institutions.

Notes to the financial statements continued

22. Financial instruments continued

Certain loans secured on residential properties are made at a fixed rate for a limited period, typically six months to five years, after which loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

The fair value of corporate and retail loans are estimated by discounting anticipated cash flows at a rate which reflects the effects of interest rate changes, adjusted for changes in credit risk.

Impaired and past due loans and advances

For impaired loans as well as past due loans, fair value is estimated by discounting the expected future cash flows using current market interest rates incorporating an appropriate risk factor or, where such loans are collateralised and have been written down to the current market value of the collateral, the estimated fair value is based on the written-down carrying value.

Deposits by customers

For fixed-term deposits by customers, fair values have been estimated using a discounted cash flow model with reference to market interest rates. For other deposits by customers, the carrying amount is a reasonable estimate of fair value.

Debt securities issued and subordinated debt

The fair values of these instruments are calculated based on quoted market prices, where available. For those instruments where quoted market prices are not available, a discounted cash flow model is used based on inputs including an interest rate yield curve developed from quoted rates and market-observable credit spreads.

Dollars in millions	30/06/20				30/06/19			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at amortised cost								
Loans and advances	-	-	22,313	22,313	-	-	20,481	20,481
Due from related parties	-	-	77	77	-	-	85	85
Financial liabilities at amortised cost								
Deposits and other borrowings	-	-	20,628	20,628	-	-	18,264	18,264
Debt securities issued	-	2,239	-	2,239	-	2,090	-	2,090
Subordinated debt	-	154	-	154	-	260	-	260
Due to related parties	-	-	7	7	-	-	9	9

23. Offsetting financial assets and liabilities



Accounting policy

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

The following tables set out the effect or potential effect of netting arrangements on the Banking Group's financial position. This includes the effect or potential effect of rights of set-off associated with the Banking Group's recognised financial assets and recognised financial liabilities that are subject to an enforceable master netting arrangement, irrespective of whether they are set off in accordance with the above accounting policy.

The financial instruments included in the following table are subject to offsetting, enforceable master netting arrangements.

Notes to the financial statements continued

23. Offsetting financial assets and liabilities continued

		30/06/20					
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral received	
Derivative financial assets	16	434	-	434	(293)	(105)	36
Total		434	-	434	(293)	(105)	36

		30/06/20					
Dollars in millions	Note	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral pledged	
Derivative financial liabilities	16	400	-	400	(293)	(105)	2
Repurchase agreements	17	202	-	202	(202) ¹	-	-
Total		602	-	602	(495)	(105)	2

¹ This is the value of investment securities pledged as collateral under a collateralised borrowing arrangement

		30/06/19					
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral received	
Derivative financial assets	16	358	-	358	(268)	(69)	21
Total		358	-	358	(268)	(69)	21

		30/06/19					
Dollars in millions	Note	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
					Financial instruments	Cash collateral pledged	
Derivative financial liabilities	16	343	-	343	(268)	(71)	4
Total		343	-	343	(268)	(71)	4

The 'Financial instruments' column identifies financial assets and liabilities that are subject to set off under netting arrangements such as International Swaps and Derivatives Association ("ISDA") master agreements. The arrangement between the Banking Group and the counterparty allows for net settlement of the relevant financial assets or financial liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and financial liabilities will be settled on a gross basis. However, each party to the master agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

Notes to the financial statements continued

24. Transfer of financial assets

The following financial assets have been transferred but have not been derecognised.

Kiwibank RMBS Trust Series 2009-1 (the “RMBS Trust”)

In May 2008 the RBNZ expanded the range of acceptable collateral that the banks can pledge and borrow against as part of changes to its liquidity management programme, designed to ensure adequate liquidity for New Zealand financial institutions. The expanded collateral criteria include the use of a pool of individual residentially-secured mortgages (loans and advances) that are aggregated together to form a residential mortgage-backed security (“RMBS”).

An RMBS can be transferred to a separate Trust allowing the Banking Group to enter into a repurchase agreement on these loans with the RBNZ. The Banking Group can borrow from the RBNZ using the RMBS as collateral until repurchased at a later date, in order to manage its liquidity requirements.

On 26 June 2009, the Banking Group established an in-house RMBS facility in order to issue securities that meet the RBNZ criteria. These assets and liabilities do not qualify for derecognition as the Banking Group retains a continuing involvement and retains substantially all the risks and rewards of ownership of the transferred assets (funding, liquidity and credit risk remains with the Banking Group).

The carrying value and fair value of the RMBS pool at 30 June 2020 is \$1,350m (30 June 2019: \$1,100m). These securities are ring fenced to ensure they are not used as collateral outside of agreements established with the RMBS Trust.

Kiwi Covered Bond Trust (the “Covered Bond Trust”)

On 23 January 2013, the Covered Bond Trust was established to hold Kiwibank housing loans and to provide guarantees to certain debt securities issued by the Banking Group. Guarantees provided by the Covered Bond Trust have a prior claim over the assets of the Covered Bond Trust. On 19 February 2013, selected Kiwibank housing loans were transferred to the Covered Bond Trust in order to establish and facilitate the Banking Group’s covered bond programme. These assets and liabilities do not qualify for derecognition as the Banking Group retains a continuing involvement and retains substantially all the risks and rewards of ownership of the transferred assets. The Covered Bond Trust is consolidated within the Banking Group.

Substantially all of the assets of the Covered Bond Trust comprise housing loans originated by Kiwibank and highly rated short-dated securities, together which are security for the guarantee of issuances of covered bonds by the Banking Group, provided by Kiwi Covered Bond Trustee Limited as Trustee of the Covered Bond Trust. The assets of the Covered Bond Trust are not available to creditors of Kiwibank, although the Banking Group (or its liquidator or statutory manager) may have a claim against the residual assets of the Covered Bond Trust (if any) after all prior ranking creditors of the Covered Bond Trust have been satisfied.

The carrying value and approximate fair value of the Covered Bond Trust pool at 30 June 2020 is \$316m (30 June 2019: \$316m). These securities are ring-fenced to ensure they are not used as collateral outside of agreements established with the Covered Bond Trust.

The financial statements of the Banking Group do not change as a result of establishing the RMBS Trust and the Covered Bond Trust.

Repurchase agreements

The Banking Group enters into sale and repurchase agreements with the wider market in order to manage short-term liquidity. Under the repurchase agreements, collateral in the form of securities is advanced to a third party and the Banking Group receives cash in exchange. The counterparty is allowed to sell or re-pledge the collateral advanced under repurchase agreements in the absence of default by the Banking Group, but has an obligation to return the collateral at the maturity of the contract. The Banking Group has determined that it retains substantially all the risks and rewards of these securities and therefore has not derecognised them (funding, liquidity and credit risk remains with the Banking Group). In addition, it recognises a financial liability for cash received which is included in ‘Due to other financial institutions’.

As at 30 June 2020, the Banking Group has recognised liabilities for an outstanding repurchase agreement of \$202m (30 June 2019: \$nil), which has a settlement date ranging up to seven days.

Transferred financial assets that are derecognised in their entirety but where the Banking Group has a continuing involvement

As at 30 June 2020, the Banking Group has not derecognised any financial assets where they have a continuing involvement (30 June 2019: \$nil).

Notes to the financial statements continued

25. Intangible assets



Accounting policy

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring the assets to use. These costs are amortised on a straight-line basis over the estimated useful lives of the licences (being 3 to 5 years). Developed software assets expected to generate net economic benefits beyond 12 months are recognised as intangible assets. The cost of developed software assets includes the cost of all materials used in construction, direct labour on the project, and an appropriate proportion of variable and fixed overheads. Developed software intangible assets are amortised over their estimated useful lives (being 3 to 15 years).

Intangible assets that are not yet available for use are assessed for impairment on at least an annual basis and whenever events or changes in circumstances indicate that the carrying amount of intangible assets may exceed their recoverable amount. Any impairment loss is recognised in the income statement as an operating expense.



Critical accounting estimates and judgements

The Banking Group's assets, including intangible assets, are assessed for indicators of impairment on at least an annual basis and whenever events or changes in circumstances indicate that the carrying amount of intangible assets may exceed their recoverable amount. In addition, intangible assets that are not yet available for use are tested annually for impairment irrespective of whether there is any indication of impairment.

The expected useful life of intangible assets, including software assets, is reviewed on an annual basis. The assessment of impairment and expected useful life requires judgement to be applied and consideration of a number of factors including but not limited to: changes in business strategy, technology, regulations, and customer preferences or requirements.

See note 2.2 for more details of the estimates and judgements applied in the Banking Group's impairment testing.

Dollars in millions	30/06/20			30/06/19		
	Internally developed			Internally developed		
	Computer software	Computer software work in progress	Total	Computer software	Computer software work in progress	Total
Cost at beginning of the year	256	11	267	237	11	248
Accumulated amortisation at beginning of the year	(193)	-	(193)	(170)	-	(170)
Carrying value at beginning of the year	63	11	74	67	11	78
Additions	-	12	12	5	16	21
Transfers from computer software work in progress	8	(8)	-	16	(16)	-
Amortisation	(22)	-	(22)	(25)	-	(25)
Amortisation released on write-off or disposal	3	-	3	2	-	2
Written off or disposed of	(2)	(5)	(7)	(2)	-	(2)
Carrying value at end of the year	50	10	60	63	11	74
Cost at end of the year	262	10	272	256	11	267
Accumulated amortisation at end of the year	(212)	-	(212)	(193)	-	(193)
Carrying value at end of the year	50	10	60	63	11	74

Write-offs and disposals of \$7.2m of intangible assets were recognised in the year ended 30 June 2020 (30 June 2019: \$2.1m). Included within write-offs of intangible assets for the period ended 30 June 2020 was an individual write-off of \$3.7m relating to computer software work in progress that no longer aligns with the Banking Group's long-term technology strategy.

Notes to the financial statements continued

26. Other assets



Accounting policy

Trade and other receivables are initially measured at fair value and subsequently at amortised cost using the effective interest method. Interest, ECL and reversals, and foreign exchange gains and losses are recognised in the income statement. Prepayments include costs paid relating to subsequent financial years and are measured at cost.

Costs incurred to obtain or fulfil a contract with a customer are recognised as an asset when the costs relate directly to a specific contract, the costs improve or create resources to use in satisfying future performance obligations of the contract, and the costs are expected to be recovered in the future. The asset is amortised within operating expenses on a systematic basis consistent with the transfer to the customer of the services to which the asset relates. See note 5 for more detail on the accounting policies related to revenue earned from contracts with customers.

Dollars in millions	30/06/20	30/06/19
Prepayments	9	5
Trade and other receivables ¹	28	25
Costs to fulfil	1	4
Total other assets	38	34
Current	36	34
Non-current	2	-

¹Other receivables includes \$2.2m of other financial assets designated at fair value through profit or loss (30 June 2019: \$0.4m).

27. Other liabilities



Accounting policy

Other liabilities are initially measured at fair value and subsequently at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement as is any gain or loss when the liability is derecognised. Other liabilities includes provisions recognised in respect of regulatory and customer remediations for expected refunds or payments to customers and other counterparties.

Dollars in millions	30/06/20	30/06/19
Trade and other payables	39	31
Employee entitlements	22	22
Other liabilities	49	49
Total other liabilities – current	110	102

In the event of liquidation, the above creditors rank in priority to subordinated debt holders and the shareholder and will rank equally with deposit holders and other creditors.

Notes to the financial statements continued

28. Leases



Accounting policy

Policy applicable after 1 July 2019

The Banking Group assesses at contract inception whether a contract is, or contains, a lease. That is, if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A single recognition and measurement approach is applied for all leases, except for short-term leases and the lease of low-value assets.

The Banking Group recognises lease liabilities to make lease payments and right-of-use assets representing the right to use the underlying assets.

i) Right-of-use assets

The Banking Group recognises right-of-use assets at the commencement date of the lease. Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities. The cost of the right-of-use assets includes the amount of lease liabilities recognised, initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received. Right-of-use assets are depreciated on a straight-line basis over the lease term.

The right-of-use assets are also subject to impairment review in line with the accounting policy in note 25.

ii) Lease Liabilities

At the commencement date of the lease, the Banking Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments less any lease incentives receivable, variable lease payments that depend on an index or a rate, and amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Banking Group and payments of penalties for terminating the lease, if the lease term reflects the Banking Group exercising the option to terminate.

Variable lease payments that do not depend on an index or rate are recognised as expenses in the period within which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Banking Group uses its incremental borrowing rate at the lease commencement date because the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the lease payments or a change in the assessment of an option to purchase the underlying asset.

iii) Short-term leases and lease of low-value assets

The Banking Group applies the short-term lease recognition exemption to its short-term leases of machinery and equipment (i.e. those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered to be low value. Lease payments on short-term leases and lease of low-value assets are recognised as an expense on a straight-line basis over the lease term.

Policy applicable before 1 July 2019

Payments made under operating leases, where the lessor substantially retains the risks and rewards of ownership, were recognised in the income statement in a systematic manner over the term of the lease. Leasehold improvements were capitalised and the cost amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever was shorter. Lease incentives received were recognised evenly over the term of the lease as a reduction in rental expense.

Notes to the financial statements continued

28. Leases continued



Critical accounting estimates and judgements

Determining the terms of lease contracts

The Banking Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease if it is reasonably certain not to be exercised. The Banking Group has a number of leases with extension and termination options and exercises judgement in evaluating if it is reasonably certain whether or not to exercise the option to renew or terminate each lease. All relevant factors that create an economic incentive to exercise an option to extend or terminate a lease are considered including, but not limited to:

- the relevant cost of lease payments at the time of the option vs expected market rates;
- the cost of the relevant leasehold improvements and their carrying value;
- the cost of terminating and relocating; and
- the importance of the underlying leased asset to the Banking Group.

Calculating incremental borrowing rates

Where the Banking Group cannot readily determine the interest rate implicit in the lease, it uses its incremental borrowing rate ("IBR") to discount future payments in measuring lease liabilities. The IBR is the rate of interest that the Banking Group would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The IBR therefore requires estimation when no observable rates are available or when adjustments are required to reflect the terms and conditions of the lease. The Banking Group estimates the IBR for each lease using observable inputs (such as market interest rates) when available.

Types of lease contracts

The Banking Group has the following lease types:

- Property leases that are either direct leases or subleases. The properties leased by the Banking Group are corporate offices and retail branch sites. Leases of corporate properties have typical lease terms of six to thirty years, inclusive of options to extend. Leases of branch sites have typical lease terms of three to nine years. Some leases provide for adjustments in rent payments for annual fixed percentage increases, market rent reviews, and changes in local price indices. The Banking Group subleases some branch sites where the head lease is held by NZP. The leases for these subleased sites are being reassessed as a result of the separation from NZP.
- ATMs that generally have lease terms of three years. These leases usually have two rights of renewal of three years resulting in a lease term of nine years.
- Vehicle leases which generally have a lease term of three years. These leases do not have an option to extend and are usually replaced at the end of the lease term when replacement vehicles are sourced.
- IT equipment which is considered short term and/or leases of low-value items. The Banking Group has elected not to recognise right-of-use assets and lease liabilities for these leases.

Previously all of the Banking Group's leases were classified as operating leases under NZ IAS 17.

Options to extend

There are several lease contracts which have extension options that are only exercisable by the Banking Group and not by the lessors. The Banking Group includes these options to extend in new leases to provide for operational flexibility. The Banking Group reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant change in circumstances that is within the Banking Group's control.

Lease commitments

The Banking Group has committed to a material lease for a corporate office in Fanshawe Street, Auckland. This lease commences on 1 November 2021, with a lease term of 12 years. The lease agreement has two extension options totalling a further 12 years. The Banking Group will assess whether it is reasonably certain to exercise these options on lease commencement.

Information about the leases for which the Group is a lessee is presented below.

i) Right-of-use assets

Dollars in millions	Property	ATM	Vehicle	Total
Balance as at 1 July 2019	80	3	1	84
Depreciation charge for the year	(12)	(1)	(1)	(14)
Additions to right-of-use assets	23	1	1	25
Balance as at 30 June 2020	91	3	1	95

Notes to the financial statements continued

28. Leases continued

ii) Lease liabilities

Dollars in millions	Property	ATM	Vehicle	Total
Balance as at 1 July 2019	80	3	1	84
Additions	23	1	1	25
Accretion of interest	2	-	-	2
Payments	(12)	(1)	(1)	(14)
Balance as at 30 June 2020	93	3	1	97

Dollars in millions	30/06/20	30/06/19
Current	12	-
Non-current	85	-
Total lease liabilities included in the balance sheet	97	-

The Banking Group had non-cash additions to right-of-use assets and lease liabilities of \$20.4m in the financial year that related to the extension of lease terms.

iii) Maturity analysis – contractual undiscounted cash flows

Dollars in millions	30/06/20
Less than one year	15
Between one and five years	53
Greater than five years	47
Total lease commitments	115

The above maturity analysis includes the undiscounted cash flows for options to extend where the Banking Group is reasonably certain to extend.

iv) Amounts recognised in profit or loss

Dollars in millions	30/06/20	30/06/19
Interest on lease liabilities	2	-
Depreciation on right-of-use assets	14	-
Variable lease payments included in the measurement of lease liabilities	1	-
Income from subleasing right-of-use assets	-	-
Expenses relating to short-term leases	-	-
Expenses relating to low-value assets, excluding short-term leases of low-value assets	-	-

v) Amounts recognised in the cash flow statement

Dollars in millions	30/06/20	30/06/19
Principal payments	12	-
Interest on lease liabilities	2	-
Total cash outflow for leases	14	-

Notes to the financial statements continued

28. Leases continued

vi) *Operating lease commitments under NZ IAS 17*

As at 30 June 2019, commitments under non-cancellable property and vehicle operating leases in respect of payments due to be made were:

Dollars in millions	30/06/19
Less than one year	13
Between one and two years	12
Between two and five years	24
Greater than five years	44
Total lease commitments	93

29. Equity



Accounting policy

Share capital

i) Ordinary shares

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

ii) Distributions

Dividends distributed in respect of shares are recognised as a liability in the financial statements in the reporting period in which the dividend distribution is approved.

Perpetual capital bonds

i) Discretionary distributions

Discretionary distributions made in respect of perpetual capital bonds are recognised as deductions from equity when paid.

Other reserves

i) Fair value reserve

The fair value reserve includes changes in the fair value of investment securities, net of tax. When the asset is derecognised these changes in fair value are transferred to the income statement. If an investment security asset held at FVOCI is impaired the associated impairment charge is recognised in the income statement.

ii) Cash flow hedge reserve

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

ORDINARY SHARES

The total authorised number of ordinary shares in Kiwibank at the reporting date was 737 million (30 June 2019: 737 million). All issued ordinary shares are fully paid. All ordinary shares have equal voting rights and share equally in dividends and surpluses on winding up. Ordinary shares do not have a par value. The whole of the issued ordinary share capital is owned by KGHL, which is incorporated in New Zealand.

Dollars in millions	30/06/20	30/06/19
Balance at beginning of the year (2020: 737m shares; 2019: 737m shares)	737	737
Issued in year (2020: nil shares; 2019: nil shares)	-	-
Balance at end of the year (2020: 737m shares; 2019: 737m shares)	737	737

Notes to the financial statements continued

29. Equity continued

RESERVES

Dollars in millions	30/06/20	30/06/19
Balance at beginning of the year	812	750
Balance adjusted for adoption of NZ IFRS 9 and NZ IFRS 15	-	(4)
Balance adjusted for adoption of NZ IFRS 16	1	-
Net profit for the year	57	108
Dividends paid on ordinary shares	(17)	(25)
Distributions to holders of perpetual capital	(11)	(11)
Net movement in cash flow hedge reserve	(22)	(12)
Net movement in fair value reserve	13	6
Balance at end of the year	833	812

CASH FLOW HEDGING RESERVE

The cash flow hedging reserve comprises the effective portion of the cumulative change in the fair value of foreign exchange and interest rate derivative contracts related to hedged forecasted transactions that have not yet occurred.

Dollars in millions	30/06/20	30/06/19
Balance at beginning of the year	(22)	(10)
Gross changes in fair value	(30)	(17)
Tax on changes in fair value	8	5
Cumulative loss transferred to the income statement	-	-
Tax effect of items transferred to income statement	-	-
Balance at end of the year	(44)	(22)

FAIR VALUE RESERVE

The fair value reserve includes the cumulative net change in the fair value of investment securities until the investment is derecognised or impaired.

Dollars in millions	30/06/20	30/06/19
Balance at beginning of the year	11	5
Gross changes in fair value	14	8
Tax on changes in fair value	(4)	(3)
Cumulative gain transferred to the income statement on disposal of financial assets	4	1
Tax effect of items transferred to income statement	(1)	-
Balance at end of the year	24	11

Capital

The Banking Group's regulatory capital is analysed in two tiers:

- Tier 1 capital, which includes ordinary shares, perpetual capital bonds ("PCB"), retained earnings including current-year profit, and the fair value reserve; and
- Tier 2 capital, which includes convertible subordinated bonds (2019: convertible subordinated bonds).

The Banking Group maintains an actively managed capital base to cover risks inherent in the business and meet the capital adequacy requirements of the RBNZ. The adequacy of the Banking Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the RBNZ in supervising the Banking Group. Further details can be found in the Capital Adequacy section of this Disclosure Statement.

During the year ended 30 June 2020, Kiwibank was in compliance with all of its externally imposed conditions of registration except as noted on page 123.

Notes to the financial statements continued

29. Equity continued

Capital management

The primary objectives of the Banking Group's capital management policy are to ensure that the Banking Group complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business.

The Banking Group manages its capital structure and makes adjustments to it according to changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Banking Group may adjust the amount of dividend payment to the shareholder, return capital to the shareholder or issue capital securities. No changes have been made to the objectives, policies and processes from the previous year. However, they are under regular review by the Board.

RBNZ Capital Review

On 5 December 2019, the RBNZ published its final decisions in respect of its proposals to reform the amount of regulatory capital required of banks incorporated in New Zealand. The key changes to the regulatory capital requirements for the Banking Group are:

- increase in the common equity tier 1 capital ratio required to 11.5%;
- increase in tier 1 capital ratio required to 14%; and
- increase in the Total Capital ratio required to 16%.

As a result of COVID-19 the new reform has been delayed by 12 months and will be implemented in stages from 1 July 2021 over a seven-year transition period. Kiwibank is already compliant with the Common Equity Tier 1 capital ratio requirement and expects to meet the other capital requirements through a combination of growth in retained earnings and the issuance of qualifying capital instruments over the transition period.

Dividends

Dollars in millions	30/06/20	30/06/19
Declared and paid during the year on ordinary shares:		
2.26 cents per share (2019: 3.41 cents per share)	(17)	(25)
Total dividends paid	(17)	(25)

Restriction on payment of dividends due to COVID-19

On 2 April 2020, the RBNZ amended the Bank's conditions of registration to restrict the Bank from making distributions of dividends on ordinary shares in line with changes for all locally incorporated banks in New Zealand during the period of economic uncertainty caused by COVID-19. The payment of discretionary sums payable to holders of Additional Tier 1 capital instrument is excluded from this restriction.

Discretionary distributions

If for any reason an interest payment on the PCBs has not been paid in full on an Interest Payment Date, Kiwibank must not, without approval of an extraordinary resolution of the holders of the PCBs:

- resolve to pay or pay any dividend on its Ordinary Shares;
- undertake any capital reduction; or
- make any payments on other capital instruments that rank equally with or junior to the PCBs (unless the payment is made in respect of capital instruments that rank equally with the PCBs and a pro rata payment is made in respect of the PCBs at the same time).

These restrictions will apply until:

- Kiwibank pays the interest payments in full on two subsequent consecutive Interest Payment Dates; and
- either:
 - the interest payments on perpetual capital notes ("PCN") issued by Kiwi Capital Funding Limited are paid in full on those dates; or
 - there are no PCNs outstanding.

Notes to the financial statements continued

30. Related entities



Critical accounting estimates and judgements

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

An SPV is consolidated and reported as part of the Banking Group if it is controlled by the Bank. The definition of control is outlined in note 2.3. As it can sometimes be difficult to determine whether the Banking Group controls an SPV, management makes judgements about the Banking Group’s power over an SPV, its exposure to variable returns and its ability to affect those returns by exercising its power.

The Banking Group consists of Kiwibank and all of its controlled entities. At the reporting date, Kiwibank had the following controlled entities:

Name of entity	Principal activity	Interest held by Kiwibank Limited	
		30/06/20	30/06/19
New Zealand Home Lending Limited	Agency services for mortgage lending through the New Zealand Home Loans Company Limited	100%	100%
AMP Home Loans Limited	Agency services for mortgage lending through the AMP Advisor network	100%	100%
Kiwibank Investment Management Limited	Provision of investment management services	100%	100%
Kiwi Asset Finance Limited	Asset finance company	100%	100%
Kiwibank PIE Unit Trust ¹ (“ PIE Unit Trust ”)	Managed portfolio investment entity	-	-
Kiwibank RMBS Trust Series 2009-1 ¹	Securitisation finance entity	-	-
Kiwi Covered Bond Trust ¹	Securitisation finance entity	-	-

¹ The Banking Group consolidates the following SPVs: PIE Unit Trust, the Kiwibank RMBS Trust Series 2009-1, Kiwi Covered Bond Trust on the basis that Kiwibank is deemed to control these entities.

Notes to the financial statements continued

30. Related entities continued

All Banking Group entities have a reporting date of 30 June and are incorporated and/or domiciled in New Zealand.

Transactions with NZP, the NZP Group, KGHL and other subsidiaries of KGHL

The “**NZP Group**” comprises NZP and its subsidiaries. “**Other subsidiaries of KGHL**” comprises KGHL subsidiaries excluding Kiwibank. The other subsidiaries of KGHL that have had transactions with the Banking Group are The New Zealand Home Loan Company Limited (“**NZHL**”), Kiwi Financial Services Retail Limited (“**KFSRL**”), Kiwi Insurance Limited (“**KI**”), Kiwi Capital Funding Limited (“**KCFL**”) and Kiwi Wealth Management and its subsidiaries. All transactions with the NZP Group, KGHL and other subsidiaries of KGHL were conducted on normal commercial terms and within the Banking Group’s approved policies. Refer to note 29 for details of dividends paid to shareholders.

All payment obligations of Kiwibank that existed at the time the NZP Guarantee was terminated on 28 February 2017, excluding any payment obligations, the terms of which expressly provide that they do not have the benefit of the guarantee, are guaranteed under the NZP Guarantee. No consideration is paid to NZP for the NZP Guarantee.

Transactions conducted with related entities including NZP, entities within the NZP Group, KGHL, and other subsidiaries of KGHL include:

- Certain shared service activities have been provided to the Banking Group in common with other NZP Group companies. The fee paid for this service is based upon activity and a mutually agreed fee.
- The Banking Group utilises a shared retail network with NZP in its provision of retail banking services to customers. The fee paid for this service is based upon activity and a mutually agreed fee. The Banking Group reimbursed KFSRL for personnel costs of \$6.7m for the year ended 30 June 2020 (2019: \$16.2m).
- During the year, NZP held a number of property leases on behalf of the Banking Group including shared sites. The Banking Group reimbursed NZP for the lease charges. At 30 June 2020, property leases held directly with NZP or shared sites where NZP recharge lease costs to the Banking Group are included within the lease commitments disclosed in note 28.
- Kiwibank is a member of, and purchases tax losses from members of, the Kiwi Group Holdings Limited Consolidated Tax Group (see note 7).
- Agency Services fee revenue and expenditure are included in the Banking Group under a management agreement whereby the Banking Group manages the Agency Services activity of NZP. Agency Services activity consists of agency collection and verification services.
- The Crown has entered into a \$300m uncalled capital facility with KGHL where KGHL can draw down capital for contingent events around Kiwibank’s conditions of registration. The annualised cost of this facility on-charged to the Banking Group by KGHL is \$3.0m (2019: \$3.0m).
- The Crown has entered into a Business Finance Guarantee Scheme with Kiwibank where the Crown has undertaken to indemnify the shortfall on defaulted support loans. The Crown’s liability is limited to an amount equal to 80% of the shortfall of each loan. As at 30 June 2020, \$8.1m of support loans have been drawn down (30 June 2019: \$nil).
- Kiwibank provides certain shared service activities to other subsidiaries of KGHL and charges for these services on an arm’s-length basis. The total charged to other subsidiaries of KGHL for shared services was \$1.7m (30 June 2019: \$2.0m).
- On 25 March 2019, KGHL entered into a loan agreement with Kiwibank, allowing KGHL to draw down \$75.5m provided that the Banking Group does not exceed credit exposure to connected persons of 15% of Tier 1 capital, as required in Kiwibank’s banking conditions of registration. When loans are drawn down under the loan agreement the transaction is undertaken at market interest rates. As at 30 June 2020 the balance of the loan owed by KGHL to the Banking Group was \$75.5m (30 June 2019: \$75.5m).
- There is a revolving credit agreement between the Banking Group and NZHL, the balance of which was \$nil at 30 June 2020 (30 June 2019: \$2.2m).
- During the year, NZHL received commissions from the Banking Group totalling \$20.2m (year ended 30 June 2019: \$18.2m).
- During the year, the Banking Group received commissions on sales of insurance policies from KI, a fellow subsidiary of KGHL, totalling \$2.0m (year ended 30 June 2019: \$2.4m).
- On 4 June 2020, the Banking Group entered into an agreement with Kiwi Insurance to provide Kiwi Cover to eligible employees. As at 30 June 2020 \$0.8m was recognised in Banking Group (2019: \$nil).

Transactions with ACC, NZSF and Guardians of New Zealand Superannuation

All transactions with ACC, NZSF and Guardians of New Zealand Superannuation were conducted on normal commercial terms and within the Banking Group’s approved policies. Refer to note 29 for details of dividends paid to shareholders.

Notes to the financial statements continued

30. Related entities continued

The table below shows balances outstanding at the reporting date with NZP, KGHL and other subsidiaries within the KGHL Group, and Guardians of New Zealand Superannuation. No individually assessed provision for credit impairment has been recognised for loans issued to or receivables due from related parties.

Dollars in millions	30/06/20	30/06/19
Outstanding balances		
NZP (due to related parties)	5	7
Other subsidiaries of KGHL (due to related parties)	2	2
Total due to related parties	7	9
Guardians of New Zealand Superannuation (deposits)	150	-
NZP (deposits)	-	-
NZP Superannuation Plan (deposits)	-	2
KGHL (deposits)	8	4
Other subsidiaries of KGHL (deposits)	6	4
Total due to related parties included in deposits	164	10
NZP (derivative financial instruments - liabilities)	-	1
Total due to related parties included in derivative financial instruments - liabilities	-	1
NZP (lease liabilities)	1	-
Total due to related parties included in lease liabilities	1	-
Other subsidiaries of KGHL (subordinated debt)	150	253
Total due to related parties included in subordinated debt	150	253
Total outstanding balances due to related parties	322	273
Receivables		
NZP (due from related parties)	-	8
KGHL (due from related parties)	76	76
Other subsidiaries of KGHL (due from related parties)	1	1
Total due from related parties per balance sheet	77	85
Other subsidiaries of KGHL (loans and advances)	-	2
Total due from related parties included in loans and advances	-	2
NZP (derivative financial instruments - assets)	-	1
Total due from related parties included in derivative financial instruments - assets	-	1
NZP (right-of-use asset)	2	-
Total due from related parties included in right-of-use assets	2	-
Total receivable from related parties	79	88
Balances due to/from related parties per balance sheet		
Payables - current	7	9
Payables - non-current	-	-
Receivables - current	77	9
Receivables - non-current	-	76

Notes to the financial statements continued

30. Related entities continued

The table below shows revenue and expenditure during the year with NZP, KGHL, and other subsidiaries of KGHL. In addition, Kiwibank undertakes some transactions with State-Owned Enterprises and government departments.

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Interest income		
Interest received or due from NZP	1	4
Interest received or due from KGHL	3	1
Total interest income received or due from related parties	4	5
Interest expense		
Interest paid or due to NZP	(1)	(4)
Interest paid or due to other subsidiaries of KGHL	-	(7)
Total interest expense paid or due to related parties	(1)	(11)
Net gains on financial instruments		
Net gains on financial instruments received or due from NZP	-	1
Total net gains on financial instruments received or due from related parties	-	1
Net fees and other income		
Other income received or due from NZP	3	15
Other income received or due from other subsidiaries of KGHL	3	4
Direct expenses paid or due to other subsidiaries of KGHL	(20)	(18)
Total net fees and other income paid or due from related parties	(14)	1
Operating expenses		
Operating expenses paid or due to NZP	(20)	(50)
Operating expenses recovered or due from NZP	4	14
Operating expenses paid or due to other subsidiaries of NZP	-	(1)
Operating expenses paid or due to other subsidiaries of KGHL	(7)	(16)
Operating expenses recovered or due from other subsidiaries of KGHL	3	3
Total operating expenses paid or due to related parties	(20)	(50)
Other transactions		
Other reimbursements paid or due to NZP	(2)	(6)
Other reimbursements received or due from other subsidiaries of KGHL	4	3
Assets purchased from NZP	(1)	(1)
Insurance reimbursements received from NZP	-	2
Loan drawdown paid to KGHL	-	(76)
Loan repayments received from NZP	-	76
Other distributions paid to other subsidiaries of KGHL	(11)	(11)

Notes to the financial statements continued

30. Related entities continued

Transactions with key management personnel

Loans made to and deposits held by key management personnel (including personally related parties) are made in the ordinary course of business on normal commercial terms and conditions, no more favourable than those given to other employees or customers. Loans are on terms of repayment that range between fixed and variable, all of which have been made in accordance with the Banking Group's lending policies. No individually assessed provision for credit impairment has been recognised for loans made to key management personnel (30 June 2019: \$nil).

Key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. This includes the Board and members of the senior executive team.

The table below shows the amount of benefits paid to key management personnel within the Banking Group.

Dollars in millions	Year ended 30/06/20	Year ended 30/06/19
Salaries and short-term benefits paid to key management personnel	7	8
Termination benefits paid to key management personnel	1	-

The table below shows the amount of loans to and deposits from key management personnel within the Banking Group.

Dollars in millions	30/06/20	30/06/19
Loans to key management personnel	-	(2)
Deposits from key management personnel	1	1

31. Fiduciary activities, securitisation and funds under management



Accounting policy

A subsidiary of the Banking Group acts as a manager for a number of unit trusts and investment funds.

The assets and liabilities of these trusts and funds are not included in the consolidated financial statements when the Banking Group does not have control of the trusts and funds. Fees earned in respect of these activities are included in Other Income. Assets purchased by any member of the Banking Group from entities which conduct insurance, securitisation, funds management, and other fiduciary activities, or on whose behalf the Banking Group conducts those activities, have been purchased on arm's-length terms and conditions.

Securitised assets are derecognised when the right to receive cash flows have expired or the Banking Group has transferred substantially all the risks and rewards of ownership (see note 24).

Insurance business

The Banking Group does not market or distribute its own insurance products.

Securitised assets

The Banking Group has an in-house RMBS facility and covered bond programme, which are discussed further in note 24.

Funds management

The Kiwibank KiwiSaver Scheme commenced accepting members and subscriptions on 1 July 2010 and closed to new members on 5 December 2012. During the year ended 30 June 2015, the Banking Group transferred the members and assets of the Kiwibank KiwiSaver Scheme to the Kiwi Wealth KiwiSaver Scheme, operated by Kiwi Wealth Limited, a fellow subsidiary of KGHL.

A subsidiary of Kiwibank also acts as the manager for the Kiwibank PIE Unit Trust. These funds are invested in products of Kiwibank and are recorded as liabilities in the balance sheet (note 18). At 30 June 2020, \$4,707m of funds under management were invested in Kiwibank's own products or securities (30 June 2019: \$4,438m).

Notes to the financial statements continued

31. Fiduciary activities, securitisation and funds under management continued

Provision of financial services

Financial services provided by Kiwibank to entities which are involved in trust, custodial, funds management and other fiduciary activities are at fair value, except that Kiwibank does not charge Kiwibank Investment Management Limited, the manager of the Kiwibank PIE Unit Trust, any bank fees. Further, the Kiwibank PIE Unit Trust bank account used for tax payments does not earn interest.

The Banking Group has not provided any funding to entities which conduct the following activities during the years ended 30 June 2020 and 30 June 2019:

- trust, custodial, funds management or other fiduciary activities established, marketed and/or sponsored by a member of the Banking Group; and
- marketing and distribution of insurance products.

Risk management

With regard to the activities identified above, the Banking Group has in place policies and procedures to ensure that those activities are conducted in an appropriate manner. Should adverse conditions arise, it is considered that these policies and procedures will minimise the possibility that these conditions will adversely impact the Banking Group. The policies and procedures include comprehensive and prominent disclosure of information regarding products, and formal and regular review of operations and policies by management and auditors.

32. Segment analysis



Accounting policy

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Kiwibank Executive Committee (“EXCO”), which consists of the chief executive and his direct reports. A reportable business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

The EXCO reviews the Banking Group’s internal reporting pack on a regular basis to assess performance and to allocate resources. Within the pack, operating segments have primarily been determined with reference to differences in products and services.

Operating segments have been aggregated for reporting purposes where the following criteria have been met:

- Aggregation is consistent with the core principle of NZ IFRS 8 Operating Segments;
- Segments have similar economic characteristics; and
- Segments are similar in each of the following respects:
 - nature of the products and services;
 - nature of the production process;
 - type or class of customer for their products and services;
 - methods used to distribute their products or provide their services; and
 - nature of the regulatory environment.

For the purposes of this note, an operating segment is a distinguishable part of the Banking Group, engaged in providing products and services which are subject to risks and returns that are different from those of other business segments. The business segments are defined by the customers that they service and the services they provide.

The EXCO assesses the performance of the operating segments based on a measure of profit before tax. This measurement basis includes a reallocation of internal overhead expenses from non-income-generating cost centres of the business. Net interest income at a segmental level includes an allocation for internal transfer pricing which eliminates to zero at a Banking Group level. Transfer pricing is allocated on a basis which reflects inter-segment funding arrangements. A summarised description of each business unit is shown below:

- Personal – Provides banking products and services to the personal banking segment via the Banking Group and NZP distribution channels.
- Business – Provides banking products and services to the business sector, via the Banking Group and NZP distribution channels. Included within the segment are Business and Treasury services.

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Banking Group’s total revenue (2019: nil).

Notes to the financial statements continued

32. Segment analysis continued

The Banking Group operates predominantly within New Zealand with no significant portion of assets or operations located outside New Zealand.

Dollars in millions	30/06/20			30/06/19		
	Personal	Business	Total	Personal	Business	Total
External net interest income	425	30	455	430	15	445
Net inter-segment interest	(138)	138	-	(140)	140	-
Net interest income	287	168	455	290	155	445
Other external operating income	76	22	98	71	22	93
Segmental revenue	363	190	553	361	177	538
Profit before impairment and taxation	48	77	125	85	78	163
Profit before taxation	11	63	74	80	71	151
Total assets	19,966	5,544	25,510	18,520	4,214	22,734
Total liabilities	17,600	6,340	23,940	15,343	5,842	21,185
Acquisition of intangible assets	10	2	12	17	4	21
Acquisition of property, plant and equipment	8	2	10	14	4	18
Amortisation expense	21	5	26	19	6	25
Depreciation expense	10	2	12	10	2	12
Depreciation on right-of-use assets	11	3	14	-	-	-
Credit impairment losses	37	14	51	7	5	12

33. Risk management

Risk management

The Banking Group's exposure to risk arises primarily from its business activities as a financial intermediary and financial markets participant. The Banking Group recognises the importance of effective risk management to its business success and to its customers. Risk management enables the Banking Group to both increase its financial and organisational growth opportunities and mitigate potential loss or damage.

Impact of COVID-19 on risk management

The Banking Group responded proactively as it became apparent COVID-19 was a clear threat to economic stability and to the ongoing effective operation of the Bank. This response included establishing additional governance processes with weekly meetings to inform the Board of the rapidly changing risk and operating environment as the pandemic spread and to seek guidance on some of the issues and challenges faced. The Bank implemented its Crisis Management Committee to manage day-to-day impacts during lockdown Alert Levels 2, 3 and 4, to ensure that core payment systems and services for customers could be maintained and to minimise the disruption to customers and staff.

The Committee addressed the specific increases in risks during that stressed operating environment including heightened liquidity risk, credit risk, customer risk, market risk, operational risk and business risk. In addition, the Committee managed the process changes necessary to keep critical staff safe during the various lockdown phases, and so that branch access could progressively resume as the lockdown levels were eased. A key role of the Committee was to provide all staff and customers with the information necessary to understand the risks the virus generated, how business activities were changing in response, and the actions that should be taken to operate effectively and to remain well.

The RBNZ enacted section 93 of the Reserve Bank of New Zealand Act 1989 in March 2020, which required all registered banks to meet regularly with the RBNZ to provide briefings on all risks being managed due to the COVID-19 virus. The frequency of the briefing meetings was initially two to three times a week, then weekly, fortnightly and monthly as New Zealand moved back out of lockdown restrictions. The Banking Group also took a number of actions to manage the new operational challenges resulting from COVID-19 including additional IT investment to reduce systems risk and to enable staff to work from home, changes to credit risk assessment processes for the most impacted regions, the roll out of customer support arrangements to impacted customers, the establishment of the Business Finance Guarantee Loans Scheme, and additional steps taken to ensure liquidity was maintained.

Notes to the financial statements continued

33. Risk management continued

Organisational perspective

The Banking Group approaches the management of risk using an organisational framework that is characterised by:

- the board approving risk appetites, business strategies, and monitoring progress;
- business unit level accountability for the management of risks in accordance with agreed strategies and the banking group's risk management framework;
- the risk management function is responsible for implementing an enterprise risk management framework and providing assurance around the management of various elements of risk; and
- independent oversight of business unit risk management by both internal and external audit functions to i) provide regular risk evaluation and reporting; and ii) assess the adequacy and effectiveness of management's control of risk.

The directors of Kiwibank are responsible for the stewardship of the Banking Group. To help discharge this obligation, the Board has established the Finance, Audit and Disclosure Committee ("**FAD**") (which includes members who have appropriate financial experience and understanding of the banking industry in which the Banking Group operates) and the Risk, Credit and Compliance Committee ("**RCC**"), which collectively are responsible for:

- review and approval of the banking group's frameworks and policies for managing business, credit, market and operational risk and maintaining an effective enterprise risk management framework;
- monitoring the banking group's key risks, performance, exposures against limits, capital levels and management of the banking group's risks;
- monitoring anticipated changes in the economic and business environment and other factors relevant to the banking group's risk profile;
- review and approval of limits and conditions that apply to risk taking;
- review of internal audit activities and significant audit issues; and
- review of financial and disclosure statements.

The following specialised principal management committees have been formed to translate Board risk appetite into appropriate strategies, policies, controls, processes and procedures for identifying, measuring and managing risk:

- ii) the Asset and Liability Committee ("**ALCO**"), which is concerned with net interest income, balance sheet structure, capital, funding and market risk;
- iii) the Executive Risk Committee ("**ERC**"), which is focused on business, credit and operational risk including reputation and conduct risk as well as continuous disclosure requirements;
- iv) the Customer & Culture Committee ("**CCC**"), which is responsible for ensuring good customer outcome principles are embedded across the Bank; and
- v) the Operational Change Forum ("**OCF**"), which considers certain risks associated with the Banking Group's key strategic projects and investment portfolio.

Independent Credit and Market risk-control units operate alongside the Banking Group's lending business units and Treasury business unit. These risk-control functions are accountable for identifying and quantifying credit and market risks respectively, and for working with the lending and Treasury business units to implement appropriate policies, procedures and controls to manage those risks. The Banking Group's Risk Management unit has been assigned the role of internal monitor. The Risk Management unit is tasked with ensuring that risk-based reporting of financial and non-financial threats to the Banking Group is undertaken on a regular basis. The unit provides an independent appraisal of business units' risk positions and the overall control environment, reporting on the Banking Group's key risks through the ERC, and onto the Board RCC and the Board FAD as appropriate. No formal reviews of the Banking Group's risk management system were undertaken by external parties during the year ended 30 June 2020.

Internal audit

The Banking Group has an independent internal audit function, which appraises the adequacy and effectiveness of the internal control environment, and reports results to management and the Board FAD. The internal audit function reports functionally to the Chair of the Board FAD and administratively to the chief financial officer.

In planning audit activities, internal audit adopts a risk-based approach that directs and concentrates resources to those areas of greatest significance, strategic concern and risk to the business. This encompasses reviews of major credit, market, technology, programmes, projects and operating risks within the Banking Group.

Significant findings are reported quarterly to the Board FAD. The audit plan is approved by the Board FAD. All issues and recommendations reported to management are tracked and monitored internally to ensure completion and agreed actions are undertaken where appropriate.

Notes to the financial statements continued

33. Risk management continued

Risk management framework

The Banking Group's risk management framework revolves around four key functions. Namely:

- **Strategic risk management** – A framework and set of processes that the Banking Group uses to plan, organise, lead and control risk management activities in an effort to minimise the effects and impacts of risk events on the Banking Group's capital and earnings. This reflects the Basel III accord requirements for a properly framed structure from which risk management strategies and policy can be devolved. This framework provides:
 - i) A high-level 'risk structure' for the classification and categorisation of all risks deemed material to the Banking Group, which forms the basis of reporting the Banking Group's risk profile.
 - ii) Risk appetite – the Banking Group's willingness to take on financial risks and a basic operational prerequisite for the establishment of consistent risk limits.
 - iii) Risk policies – these explicitly articulate the Banking Group's fundamental attitude towards risk and risk management. The risk policy statements are intended to ensure employees understand the Banking Group's risk management goals throughout the organisation.
 - iv) Risk principles – these are central rules for risk management decision-making and form the basis for maximum uniformity in risk management decision-making.
- **Capital management and capital adequacy** – the Banking Group's capital management strategy seeks to ensure the Banking Group is adequately capitalised while recognising capital is often an expensive form of funding or insurance. The Banking Group seeks to maintain and acquire capital in an economically effective manner so as to: i) support future development and growth aspirations; ii) comply with regulatory capital requirements; iii) maintain a strong internal capital base to cover all material inherent risks; and iv) maintain an investment grade credit rating.

The Banking Group undertakes a programme of activities designed to ensure that it has sufficient financial resources to continue as a going concern even if it suffers a material unforeseen or unexpected risk event(s). This programme, called the Internal Capital Adequacy Assessment Programme ("ICAAP"), deals primarily with assessing the Banking Group's capacity to absorb risk based on: i) identification and quantification of its immediate risks; and ii) comparison of those risks with its financial capital (that may have to be sacrificed if these risks materialise). The Board of Directors has ultimate responsibility for capital adequacy and approves capital policy and minimum internal capital levels and limits.

In ensuring that the Banking Group has adequate overall capital in relation to its risk profile, a mixture of risk capital estimates and judgement-based estimates have been made relating to all material risks, even where they are hard to quantify. Included in these estimates is also a trade-off between the importance of allocating capital to such risks and the robustness of the Banking Group's approach to mitigating and managing these risks.

The Banking Group monitors its key risks and internal and regulatory capital adequacy, and reports on these to the Board Risk, Credit and Compliance Committee and the Finance, Audit, and Disclosure Committee. In the event of large, unexpected losses, the Banking Group is committed to restoring its capital position. Management has developed plans accordingly.

- **Risk assessment and risk prioritisation** – This function, administered by the Risk Management Unit, is designed to identify and assess the real risks facing the Banking Group. The prioritisation process is intended to ensure that management focus and appropriate resources are directed at isolating, reducing or controlling expected (probable) risk events. The risk prioritisation process involves assessing the probability and severity of losses using (where possible) quantitative risk and control data.
- **Enterprise risk management** – Irrespective of their relative significance, the majority of risk situations facing the Banking Group occur in the day-to-day operations of the business. These risks (referred to as enterprise risks – as they arise from operating the business) are not confined to formal risk domains (i.e. credit, market, or operational risk) or business lines. As it is considered desirable to manage risk in a consistent and comprehensive manner across the whole of the Banking Group, a decision support model exists for any manager needing to make a risk management decision about a specific risk matter arising in their current or proposed operations (i.e. day-to-day business activities).

Risk appetite and supporting policy frameworks

The risk appetite framework is a key element of the enterprise risk management framework as it expresses the amount and type of risk Kiwibank is willing to accept in pursuing its strategic objectives.

Notes to the financial statements continued

33. Risk management continued

The Banking Group's high level risk structure recognises eight main types of risk (or risk domains). Specifically:

- **Credit risk** – the risk of financial loss arising from the failure of a customer or counterparty to honour any financial or contractual obligation.
- **Market risk** – the potential for losses arising from adverse movements in the level and volatility of market factors, such as interest rates and foreign exchange rates. This risk domain also includes the risk that the Banking Group will not have sufficient funds available to meet financial and transactional cash-flow obligations.
- **Balance Sheet Use risk** – the risk that the Banking Group has insufficient capital or sub-optimal quality of capital to ensure that strategic initiatives be adopted or that capital is efficiently deployed.
- **Delivery risk** – the risk that investments in new strategies and systems cost more, take longer to implement, and/or fail to deliver the expected benefits so that the Bank is disadvantaged when compared to peers.
- **Customer risk** – the risk the Bank is unable to adapt sufficiently to meet the changing demands and expectations of current and future customers so that it cannot achieve its business goals and strategies. This includes the risk of material customer attrition and loss of brand value.
- **Conduct risk** – inappropriate, unethical or unlawful behaviour on the part of the Banking Group's management or employees, including the conduct of the Banking Group as a whole.
- **Operational risk** – the risk of direct or indirect losses resulting from inadequate or failed internal processes, people and systems, or from external events. This risk domain includes legal and regulatory risk, which includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from regulatory actions, as well as private settlements.
- **Business risk** – macro or micro environmental events that could impede or prevent the Bank achieving its stated business goals or strategies, including missed opportunities and potential losses/damage arising from poor strategic business decisions. This risk includes material changes in the global and domestic economic environment impacting credit and liquidity flows.

Credit risk

The Banking Group's credit risks arise from lending to customers and from inter-bank, treasury, international and capital market activities. The Banking Group has clearly defined credit policies and frameworks for the approval and management of credit risk.

Key elements of the credit risk management framework are:

- **Credit risk management** – the Board requires sound lending growth for appropriate returns. The Banking Group pursues this objective in a structured manner, managing credit risk through application of sector-specific credit underwriting standards including scorecards, a robust control environment, monitoring of the portfolios, review of all major credit risks and risk concentrations, and through a tiered structure of delegated lending authorities designed to control the multiple facets of credit risk management.

Notes to the financial statements continued

33. Risk management continued

An independent credit management function staffed by credit risk specialists exists to: provide independent credit decisions; support front-line lending staff in the application of sound credit practices; provide centralised remedial management of troublesome and impaired accounts; and undertake portfolio monitoring and loan asset quality analysis and reporting.

The integrity and effectiveness of the Banking Group's credit risk management practices, asset quality and compliance with policy are supported by independent assessments by the Quality Assurance and Internal Audit functions.

- **Credit risk mitigation** – The Banking Group's Board-approved wholesale credit management policy sets out the parameters for which it can enter into credit exposures arising from on and off-balance sheet transactions. The Banking Group also has legal arrangements with its major institutional counterparties to allow netting of off-balance sheet exposures, along with collateral management arrangements.
- **Portfolio structure and monitoring** – The Banking Group's credit portfolio is divided into two asset classes: retail and corporate. The retail asset class is comprised of housing loan, credit card and personal lending facilities and small-to-medium-enterprise business lending. This segment is managed on a delinquency band approach and on a behavioural basis.

The corporate asset class consists of lending to middle market and corporate businesses. Each exposure is assigned an internal risk rating that is based on an in-depth assessment of the risk of default. These exposures are required to be reviewed on an annual basis. The overall composition and quality of the credit portfolios is monitored taking into account the potential changes in economic conditions.

- **Credit approval standards** – The Banking Group has clearly defined credit underwriting policies and standards for all lending, which incorporate income and repayment capacity, acceptable terms, security, and loan documentation criteria. In the first instance, the Banking Group relies on the assessed integrity and character of the customer or counterparty and their capacity to honour their financial obligations for repayment.

Longer-term consumer lending is generally secured against real estate, while short-term revolving consumer credit (overdraft, credit card and personal lending) is generally unsecured. The Banking Group requires adequate and sustainable debt servicing capacity, and may also require security cover within loan-to-security ratios as set out in the Banking Group's credit policy.

Collateral security in the form of real property and/or general security interest over business assets is generally taken for business credit, except for government, bank and corporate counterparties of strong financial standing. The Banking Group uses ISDA agreements to document derivative activities and limit exposures to credit losses. Under ISDA protocols, in the event of default, all contracts with the counterparty are terminated and settled on a net basis.

- **Problem credit facility management** – Credit exposures are monitored regularly through the examination of irregular and delinquent accounts. This enables doubtful debts to be immediately identified so that specific provisions for potential losses can be established as early as possible. Problem credit facilities are monitored to ensure workout and collection and recovery strategies are established and enacted promptly to minimise risk of potential losses.

Credit risk portfolios are regularly assessed for objective evidence of impairment. The Banking Group maintains a collectively assessed credit impairment provision using forward-looking forecasts and potential future cash flows and current risk factors. The Banking Group also recognises an individually assessed impairment provision for impairment against specific credit exposures when there is objective evidence that it will not be able to collect all amounts due.

- **Operations control environment** – Operationally, credit risk is controlled through a combination of approvals, limits, monitoring and review procedures which are carried out on a regular basis. Functions are segregated so that no one person is able to control all significant stages of the credit process, thereby reducing the chance of error or defalcation escaping detection. Preparation of formal lending documentation only occurs after an independent officer in the operations area has verified that the credit facility has been properly approved and the facility documentation matches the terms of the credit approval.

Notes to the financial statements continued

33. Risk management continued

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

- 0 – 3: Strong;
- 4 – 5: Good;
- 6 – 7: Satisfactory;
- 8 – 9: Weak; and
- 10 – 12: Credit impaired.

Dollars in millions	30/06/20				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Credit exposure by risk grade					
Risk bands:					
0 – 3	13,503	29	-	-	13,532
4 – 5	5,625	407	-	-	6,032
6 – 7	2,310	314	-	-	2,624
8 – 9	-	91	-	-	91
10 – 12	-	-	27	2	29
Total credit exposure by risk grade	21,438	841	27	2	22,308

Dollars in millions	30/06/19				Total
	Stage 1	Stage 2	Stage 3		
	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	
Credit exposure by risk grade					
Risk bands:					
0 – 3	12,655	46	-	-	12,701
4 – 5	5,219	360	-	-	5,579
6 – 7	1,796	284	-	-	2,080
8 – 9	6	91	-	-	97
10 – 12	-	-	21	5	26
Total credit exposure by risk grade	19,676	781	21	5	20,483

Market risk

Market risk arises from the mismatch between assets and liabilities in the banking business. In order to manage its own exposure to market risk, the Banking Group transacts in derivative instruments such as swaps, options, futures and forward-rate agreements. These activities are managed using structural limits (including volume and basis point value limits) in conjunction with scenario analysis. Market risk limits are allocated based on business strategies, modelling and experience, in addition to market liquidity and risk concentration analysis.

Key elements of the Banking Group's market risk management framework are outlined below.

Interest rate risk management

The Board expects reasonable stability in the Banking Group's net interest income over time. The Banking Group's treasury business unit has been tasked with managing the sensitivity of net income to changes in wholesale market interest rates. This sensitivity (known as structural interest rate risk) arises from the Banking Group's lending and deposit-taking activities and investment of capital and other liabilities. The provision of loans and accepting deposits at both fixed and variable rates gives rise to the risk that the Banking Group could have unmatched positions leading to material exposures in a shifting interest rate environment. Other activities such as current account facilities and trading financial instruments such as swaps, options and forward-rate agreements also incur interest rate risks.

Notes to the financial statements continued

33. Risk management continued

The main objective of the management of interest rate risk is to achieve a balance between reducing risk to earnings from the adverse effect of interest rate movements and enhancing net interest income through the correct anticipation of the direction and extent of interest rate changes.

The ALCO (comprising executive management) is responsible for implementing and monitoring interest rate risk management policies within Board-defined policy guidelines and limits. Interest rate risk is managed by the treasury business unit within pre-approved limits.

Interest rate risk is measured in terms of the Banking Group's notional exposure to potential shifts in future interest rates relative to the timescale within which assets and liabilities can be repriced. A separate independent Market Risk Management Unit ("MRMU") is responsible for the daily measurement and monitoring of market risk exposures.

The Banking Group reduces interest rate risk by seeking to match the repricing of assets and liabilities. A substantial portion of customer deposits and lending is at variable rates, which are periodically adjusted to reflect market movements. Where natural hedging still leaves an interest rate mismatch, the residual risks are hedged within pre-defined limits through the use of physical financial instruments, interest rate swaps and other derivative financial instruments.

The following tables summarise the Banking Group's exposure to interest rate risk. They include the financial instruments at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

Interest rate repricing schedule

Dollars in millions	30/06/20						
	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	492	62	430	-	-	-	-
Due from related parties	77	1	76	-	-	-	-
Due from other financial institutions	105	-	105	-	-	-	-
Investment securities	1,895	-	308	40	440	36	1,071
Derivative financial instruments	434	434	-	-	-	-	-
Loans and advances	22,222	17	6,282	3,036	6,898	4,881	1,108
Other financial assets	27	27	-	-	-	-	-
Total financial assets	25,252	541	7,201	3,076	7,338	4,917	2,179
Financial liabilities							
Due to other financial institutions	(317)	(10)	(307)	-	-	-	-
Due to related parties	(7)	(7)	-	-	-	-	-
Deposits and other borrowings	(20,597)	(3,353)	(12,170)	(3,049)	(1,546)	(265)	(214)
Derivative financial instruments	(400)	(400)	-	-	-	-	-
Debt securities issued	(2,229)	-	(571)	(420)	(235)	-	(1,003)
Other financial liabilities	(70)	(70)	-	-	-	-	-
Lease liabilities	(97)	(97)	-	-	-	-	-
Subordinated debt	(150)	-	-	-	-	-	(150)
Total financial liabilities	(23,867)	(3,937)	(13,048)	(3,469)	(1,781)	(265)	(1,367)
On-balance sheet gap	1,385	(3,396)	(5,847)	(393)	5,557	4,652	812
Net derivative notional principals	75	-	6,266	(503)	(3,270)	(2,939)	521
Net effective interest rate gap	1,460	(3,396)	419	(896)	2,287	1,713	1,333

Notes to the financial statements continued

33. Risk management continued

Interest rate repricing schedule continued

Dollars in millions	30/06/19						
	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	421	38	383	-	-	-	-
Due from related parties	85	9	76	-	-	-	-
Due from other financial institutions	71	-	71	-	-	-	-
Investment securities	1,176	-	192	-	486	344	154
Derivative financial instruments	358	358	-	-	-	-	-
Loans and advances	20,443	68	5,732	2,600	4,502	6,344	1,197
Other financial assets	25	25	-	-	-	-	-
Total financial assets	22,579	498	6,454	2,600	4,988	6,688	1,351
Financial liabilities							
Due to other financial institutions	(126)	(58)	(68)	-	-	-	-
Due to related parties	(9)	(9)	-	-	-	-	-
Deposits and other borrowings	(18,240)	(2,314)	(9,696)	(3,361)	(2,261)	(394)	(214)
Derivative financial instruments	(343)	(343)	-	-	-	-	-
Debt securities issued	(2,078)	-	(790)	(157)	(286)	(279)	(566)
Other financial liabilities	(63)	(63)	-	-	-	-	-
Subordinated debt	(253)	-	(104)	-	(149)	-	-
Total financial liabilities	(21,112)	(2,787)	(10,658)	(3,518)	(2,696)	(673)	(780)
On-balance sheet gap	1,467	(2,289)	(4,204)	(918)	2,292	6,015	571
Net derivative notional principals	35	-	3,389	829	(906)	(4,178)	901
Net effective interest rate gap	1,502	(2,289)	(815)	(89)	1,386	1,837	1,472

Notes to the financial statements continued

33. Risk management continued

Currency risk management

Currency risk results from the mismatch of foreign currency assets and liabilities. These mismatches can arise from the day-to-day purchase and sale of foreign currency and from deposit and lending activity in foreign currencies. The Banking Group has a policy of hedging all foreign currency borrowing into New Zealand dollars. Residual currency risks are monitored daily in terms of open positions in each currency and are managed within pre-approved limits.

The Banking Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in aggregate for overnight positions, which are monitored daily. The table below summarises the Banking Group's exposure to foreign currency exchange rate risk as at the reporting date. Included in the table are financial instruments at New Zealand dollar carrying amounts, categorised by currency.

Dollars in millions	30/06/20							Total
	NZD	CHF	AUD	USD	GBP	EUR	Other	
Assets								
Cash and cash equivalents	425	1	10	27	11	16	2	492
Due from related parties	77	-	-	-	-	-	-	77
Due from other financial institutions	105	-	-	-	-	-	-	105
Investment securities	1,895	-	-	-	-	-	-	1,895
Derivative financial instruments	(541)	504	262	120	(13)	(5)	107	434
Loans and advances	22,216	-	2	2	-	2	-	22,222
Other financial assets	27	-	-	-	-	-	-	27
Total financial assets	24,204	505	274	149	(2)	13	109	25,252
Liabilities								
Due to other financial institutions	(237)	-	-	(80)	-	-	-	(317)
Due to related parties	(7)	-	-	-	-	-	-	(7)
Deposits and other borrowings	(20,507)	-	(19)	(65)	(5)	(1)	-	(20,597)
Derivative financial instruments	(476)	-	36	24	17	(5)	4	(400)
Debt securities issued	(1,355)	(499)	(266)	-	-	-	(109)	(2,229)
Other financial liabilities	(70)	-	-	-	-	-	-	(70)
Lease liabilities	(97)	-	-	-	-	-	-	(97)
Subordinated debt	(150)	-	-	-	-	-	-	(150)
Total financial liabilities	(22,899)	(499)	(249)	(121)	12	(6)	(105)	(23,867)
Net on-balance sheet financial position	1,305	6	25	28	10	7	4	1,385

Notes to the financial statements continued

33. Risk management continued

Currency risk management continued

Dollars in millions	30/06/19							Total
	NZD	CHF	AUD	USD	GBP	EUR	Other	
Assets								
Cash and cash equivalents	351	1	5	24	13	19	8	421
Due from related parties	85	-	-	-	-	-	-	85
Due from other financial institutions	71	-	-	-	-	-	-	71
Investment securities	1,176	-	-	-	-	-	-	1,176
Derivative financial instruments	(412)	479	152	45	(8)	(2)	104	358
Loans and advances	20,437	-	1	3	-	2	-	20,443
Other financial assets	25	-	-	-	-	-	-	25
Total financial assets	21,733	480	158	72	5	19	112	22,579
Liabilities								
Due to other financial institutions	(68)	-	-	(58)	-	-	-	(126)
Due to related parties	(9)	-	-	-	-	-	-	(9)
Deposits and other borrowings	(18,047)	(1)	(42)	(107)	(24)	(14)	(5)	(18,240)
Derivative financial instruments	(645)	-	153	137	18	(5)	(1)	(343)
Debt securities issued	(1,229)	(472)	(251)	(22)	-	-	(104)	(2,078)
Other financial liabilities	(63)	-	-	-	-	-	-	(63)
Subordinated debt	(253)	-	-	-	-	-	-	(253)
Total financial liabilities	(20,314)	(473)	(140)	(50)	(6)	(19)	(110)	(21,112)
Net on-balance sheet financial position	1,419	7	18	22	(1)	-	2	1,467

Liquidity and funding risk management

Liquidity risk is the risk that the Banking Group will not have sufficient funds available to meet its financial and transactional cash-flow obligations. Management of liquidity risk is designed to ensure that the Banking Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis. The treasury business unit has responsibility for liquidity management, under oversight of the ALCO.

The Banking Group monitors this risk daily, primarily by forecasting future cash requirements, both under normal conditions and during crisis situations. The Banking Group manages this by: holding readily tradable, investment assets that are eligible for the RBNZ's repurchase facilities, and short-term investments with high-credit quality counterparties to provide for any unexpected patterns in cash movements; and seeking a stable funding base.

The Banking Group maintains liquidity crisis contingency plans defining an approach for responding to liquidity-threatening events. Funding risk is allied to liquidity risk, but is concerned with the Banking Group's capacity to fund increases in assets while meeting its payment obligations, including repaying depositors and managing maturing wholesale debt.

The Banking Group employs asset and liability cash-flow modelling to determine appropriate liquidity and funding strategies. This modelling helps ensure that an appropriate portion of the Banking Group's assets is funded by customer liabilities, bank borrowing, and equity. This approach also recognises the favourable liquidity characteristics of long-term customer liabilities and wholesale debt funding, in reducing the impact or volatility of short-term funding.

Notes to the financial statements continued

33. Risk management continued

Under normal business conditions, the Banking Group seeks to satisfy the majority of its funding needs from retail liabilities. The Banking Group's borrowing capacity is an estimate of the amount of funding that can be raised in the wholesale markets. The Banking Group's funding strategy is designed to deliver a sustainable portfolio of wholesale funds.

The treasury business unit (under oversight of the ALCO) is responsible for monitoring the Banking Group's funding base and ensuring that this base is prudently maintained and adequately diversified.

Liquidity risk management process

The Banking Group's liquidity management responsibilities include:

- Day-to-day liquidity requirements. The RBNZ's liquidity ratios are calculated and monitored daily to ensure that the Group:
 - is compliant with part 13 of the conditions of registration and the RBNZ's "Liquidity policy" (BS13);
 - maintains a prudent level of cash and highly liquid assets ("**primary liquid assets**") and marketable assets of limited credit risk ("**secondary liquid assets**") to meet both expected and projected outflows under severe funding stress from the wholesale and retail balance sheet over a one-week and one-month period; and
 - maintains a diversified stable funding base.
- Securing an appropriately matched profile of future cash flows from maturing assets and liabilities.
- Implementing the Banking Group's funding plan, which includes the development of sustainable wholesale funding capacity.
- Stress-testing the Banking Group's funding and liquidity position with a range of adverse events covering:
 - a Kiwibank name crisis;
 - an international credit crisis; and
 - a Kiwibank name event, combined with domestic funding stress.

The Banking Group holds a diversified portfolio of high-quality liquid securities to support its liquidity risk management. The size of the Banking Group's liquidity portfolio is based on the amount required to meet its liquidity policy and includes items both classified as cash and cash equivalents and those classified as operating assets in the cash flow statement. Amounts below are presented net of any appropriate 'haircut' where applicable.

	30/06/20	30/06/19
Cash, balances with central bank, and certain foreign currency deposits	437	398
Certificates of deposit	76	18
Government bonds and treasury bills	651	470
Local body stock and bonds	133	4
Other bonds	717	625
Total	2,014	1,515

The Bank also held unencumbered internal residential mortgage-backed securities which would entitle the Banking Group to enter into repurchase transactions with a value of \$1,050m at 30 June 2020 (30 June 2019: \$855m).

Non-derivative cash flows

The tables on the following pages summarise the cash flows payable by the Banking Group under non-derivative financial liabilities by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows. The Banking Group does not manage liquidity risk on the basis of the information provided below.

Derivative cash flows

a) Derivatives settled on a net basis

The tables on the following pages analyse the Banking Group's derivative financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows using forward rates.

b) Derivatives settled on a gross basis

The tables on the following pages analyse the Banking Group's derivative financial instruments that will be settled on a gross basis into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows using forward rates.

Notes to the financial statements continued

33. Risk management continued

Dollars in millions	30/06/20						Carrying amount
	On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Gross nominal inflow/outflow	
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(317)	-	-	-	-	(317)	(317)
Due to related parties	(7)	-	-	-	-	(7)	(7)
Deposits and other borrowings	(9,418)	(6,174)	(4,667)	(437)	-	(20,696)	(20,597)
Debt securities issued	-	(127)	(676)	(1,330)	(177)	(2,310)	(2,229)
Other financial liabilities	(70)	-	-	-	-	(70)	(70)
Lease liabilities	(1)	(2)	(12)	(53)	(47)	(115)	(97)
Subordinated debt	-	-	-	-	(150)	(150)	(150)
Total financial liabilities	(9,813)	(6,303)	(5,355)	(1,820)	(374)	(23,665)	(23,467)
Assets							
Cash and cash equivalents	492	-	-	-	-	492	492
Due from related parties	1	1	77	-	-	79	77
Due from other financial institutions	105	-	-	-	-	105	105
Investment securities	33	159	551	1,161	16	1,920	1,895
Loans and advances	208	386	1,323	4,858	33,345	40,120	22,222
Other financial assets	27	-	-	-	-	27	27
Total financial assets	866	546	1,951	6,019	33,361	42,743	24,818
Net non-derivative cash flows	(8,947)	(5,757)	(3,404)	4,199	32,987	19,078	
Derivative cash flows - net							
Interest rate derivatives	(11)	(8)	(53)	2	-	(70)	
Total	(11)	(8)	(53)	2	-	(70)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	161	143	536	472	177	1,489	
Outflow	(163)	(143)	(477)	(427)	(180)	(1,390)	
Total	(2)	-	59	45	(3)	99	
Off-balance-sheet cash flows							
Capital commitments	(1)	(5)	-	-	-	(6)	
Undrawn credit commitments	(3,827)	-	-	-	-	(3,827)	
Total	(3,828)	(5)	-	-	-	(3,833)	
Net cash flows	(12,788)	(5,770)	(3,398)	4,246	32,984	15,274	
Cumulative net cash flows	(12,788)	(18,558)	(21,956)	(17,710)	15,274	15,274	

Included within subordinated debt are perpetual capital bonds which have no fixed maturity date. The repayment of the principal amount of the perpetual capital bonds has been included in the 'More than 5 years' column.

Notes to the financial statements continued

33. Risk management continued

Dollars in millions	30/06/19						Carrying amount
	On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Gross nominal inflow/outflow	
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(126)	-	-	-	-	(126)	(126)
Due to related parties	(9)	-	-	-	-	(9)	(9)
Deposits and other borrowings	(6,978)	(5,007)	(5,798)	(604)	-	(18,387)	(18,240)
Debt securities issued	(5)	(234)	(679)	(1,096)	(184)	(2,198)	(2,078)
Other financial liabilities	(63)	-	-	-	-	(63)	(63)
Subordinated debt	(103)	-	-	-	(150)	(253)	(253)
Total financial liabilities	(7,284)	(5,241)	(6,477)	(1,700)	(334)	(21,036)	(20,769)
Assets							
Cash and cash equivalents	421	-	-	-	-	421	421
Due from related parties	9	1	2	79	-	91	85
Due from other financial institutions	71	-	-	-	-	71	71
Investment securities	42	14	559	587	-	1,202	1,176
Loans and advances	198	391	1,250	4,590	32,528	38,957	20,443
Other financial assets	25	-	-	-	-	25	25
Total financial assets	766	406	1,811	5,256	32,528	40,767	22,221
Net non-derivative cash flows	(6,518)	(4,835)	(4,666)	3,556	32,194	19,731	
Derivative cash flows - net							
Interest rate derivatives	(3)	(4)	(23)	(11)	(1)	(42)	
Total	(3)	(4)	(23)	(11)	(1)	(42)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	178	191	304	725	184	1,582	
Outflow	(183)	(191)	(303)	(662)	(191)	(1,530)	
Total	(5)	-	1	63	(7)	52	
Off-balance-sheet cash flows							
Capital commitments	-	(3)	-	-	-	(3)	
Undrawn credit commitments	(3,411)	-	-	-	-	(3,411)	
Lease commitments	-	(3)	(10)	(36)	(44)	(93)	
Total	(3,411)	(6)	(10)	(36)	(44)	(3,507)	
Net cash flows	(9,937)	(4,845)	(4,698)	3,572	32,142	16,234	
Cumulative net cash flows	(9,937)	(14,782)	(19,480)	(15,908)	16,234	16,234	

The comparative prior period amounts have been reclassified to align with the categories used in the current period's presentation. A total of \$137m of deposits and other borrowings have been reclassified to 'On demand' to recognise the portion of the deposit where the customer has a right to break up to 20% over the life of the deposit.

Notes to the financial statements continued

33. Risk management continued

Equity risk

Equity risk results from the repricing of equity investments. The Banking Group does not undertake equity trading and there are no significant exposures to equity instruments.

OPERATIONAL AND COMPLIANCE RISK

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk. Operational risk is mitigated by implementing the necessary process, systems and training regimes.

Compliance risk, a subset of operational risk, is the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory standards and codes of conduct applicable to its banking activities.

Operational risk is inherent in the Banking Group's activities. Inadequate practices to identify and assess operational risk can lead to non-compliance, sanctions, fines/penalties and losses due to errors, compensation and internal fraud. Failure of processes/systems or human error could result in poor customer service or experience.

Operational risk covers a broad spectrum of activities, and is categorised into seven specific 'event types':

- internal fraud;
- external fraud;
- employment practices and workplace safety;
- clients, products and business practices (Note: This category includes a large proportion of Kiwibank's compliance risks.);
- damage to physical assets;
- business disruption and system failures; and
- execution, delivery and process management.

Operational risk management within the Banking Group is based on the following core elements:

- Operational risk management relies on the support and participation of all Banking Group staff. Senior management is accountable to the Board for maintaining an adequate and effective control environment that is commensurate with the Banking Group's risk appetite and business objectives.
- Business units are responsible for the management of their operational risks. Each business area is responsible for the identification, measurement, monitoring and mitigation of operational risk in their areas of responsibility.
- A central Risk Management Unit owns and manages the operational risk and compliance framework and provides guidance, assurance, review and challenge and bank-wide risk reporting to relevant governance committees.

General managers provide attestations regarding their operational risk and compliance systems and any weaknesses. A summary of the responses and any issues identified is reported to the Executive Risk Committee and to the Board Finance, Audit and Disclosure Committee.

BUSINESS RISK

There are numerous external and internal uncertainties that may derail the business strategies or goals of the Banking Group. Success in managing business risk is intrinsically more difficult than managing financial risks (i.e. credit, market and operational risks).

It is only through sound business strategies and skilful execution of these business strategies that the Banking Group's business goals/objectives will be achieved. Risk management strategies are not a substitute for good business strategies but aid in the selection of appropriate strategies and in their successful execution.

The Banking Group has three core business risk management strategies aimed at supporting its business strategies. Specifically:

- establishment and maintenance of an internal organisational environment in which business and strategic risk can meaningfully be managed;
- establishment and maintenance of structures, measurement basis and risk management processes for the evaluation and management of business and strategic risks; and
- building capability within the Banking Group to enable both the pursuit of opportunities and mitigation of vulnerabilities.

Notes to the financial statements continued

33. Risk management continued

CUSTOMER RISK

Customers continually challenge banks to improve products and services and they increasingly measure bank performance against service levels provided by organisations with quite different business models. New entrants seek to disrupt existing industries also, including payments processing and banking and finance, with offerings that are not tied to existing physical channels or operational practices.

The Bank seeks to place the customer at the centre of its business transformation strategies but there remains some uncertainty as to whether those strategies will be successful over the longer term.

RISK GOVERNANCE

Risk governance encompasses the roles and responsibilities of the Board, Chief Risk Officer (“**CRO**”) and the risk management function, and an independent assessment of the key risks facing the enterprise as well as the effectiveness of policies and processes in place to manage those risks.

Support is provided in the Risk Division led by the CRO and the Enterprise Risk Management unit teams, who provide the framework, methodologies and tools that quantify and communicate the level of risk the Banking Group is willing to accept to management.

Key elements of the Enterprise Risk Management function are:

- **Risk appetite and supporting policy frameworks** – Risk appetite and culture are embedded in a range of frameworks and policy statements. This includes the enterprise risk management framework, the Bank’s Risk Appetite Statements, and credit risk policies including the principles of lending. The granular risk appetite is also expressed by a series of risk tolerances that guide day-to-day decision-making. Risk appetite is ultimately defined and approved by the Board of Directors, and implemented by Kiwibank’s management.
- **Quality assurance of credit activities** – This provides assurance that the Credit Policy, processes and systems are being used as designed, both by individual staff and systematically across the Banking Group.
- **The risk governance function** – This includes reviewing material credit change initiatives to ensure they are working as designed and producing the intended outcomes.
- **Model assurance** – This provides assurance that models are fit for purpose and working as intended. The function is tasked with developing model validation and verification standards with the primary focus on models used for rating credit exposure or for regulatory reporting.

Notes to the financial statements continued

34. Sensitivity analysis

The tables below summarise the pre-tax sensitivity of financial assets and financial liabilities to changes in two risk variables: interest rate and currency risks. The sensitivity to interest rate movements models the impact of a 1% parallel movement, both up and down, in the yield curve on fair values and earnings.

Fair value sensitivity assesses whether changes in the fair value impact the net profit (e.g., financial assets held for trading) or equity (e.g. investment securities and cash flow hedges) only; market values are used as the basis for this calculation.

Earnings sensitivity calculates the impact on net profit for the previous year of a 1% movement in interest rate based on financial assets and liabilities that have repriced over the previous year that were held at the reporting date. Where a decrease of 1% would result in a negative interest rate for retail deposits, a minimum rate of 0% has been applied.

The sensitivity to currency movements models the impact on net profit of a 10% movement, both up and down, in the New Zealand dollar relative to all currencies where Kiwibank held a material exposure at the reporting date. Any changes in the value of financial assets and financial liabilities due to currency movements are considered to impact net profit and, therefore, equity equally.

Interest rate risk - fair value	Carrying amounts	30/06/20			
		-1%	+1%	-1%	+1%
Dollars in millions		Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	492	-	-	-	-
Due from related parties	77	-	-	-	-
Due from other financial institutions	105	-	-	-	-
Investment securities	1,895	-	-	45	(43)
Derivative financial instruments	434	105	(100)	131	(125)
Loans and advances	22,222	-	-	-	-
Other financial assets	27	-	-	-	-
Total financial assets	25,252	105	(100)	176	(168)
Financial liabilities					
Due to other financial institutions	317	-	-	-	-
Due to related parties	7	-	-	-	-
Deposits and other borrowings	20,597	-	-	-	-
Derivative financial instruments	400	(74)	70	(171)	165
Debt securities issued	2,229	(40)	38	(40)	38
Lease liabilities	97	-	-	-	-
Other financial liabilities	70	-	-	-	-
Subordinated debt	150	(3)	3	(3)	3
Total financial liabilities	23,867	(117)	111	(214)	206

Notes to the financial statements continued

34. Sensitivity analysis continued

Interest rate risk - fair value	30/06/19				
		-1%	+1%	-1%	+1%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	421	-	-	-	-
Due from related parties	85	-	-	-	-
Due from other financial institutions	71	-	-	-	-
Investment securities	1,176	-	-	16	(16)
Derivative financial instruments	358	136	(129)	174	(166)
Loans and advances	20,443	-	-	-	-
Other financial assets	25	-	-	-	-
Total financial assets	22,579	136	(129)	190	(182)
Financial liabilities					
Due to other financial institutions	126	-	-	-	-
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	-	-	-	-
Derivative financial instruments	343	(104)	99	(195)	188
Debt securities issued	2,078	(29)	28	(29)	28
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	(1)	1	(1)	1
Total financial liabilities	21,112	(134)	128	(225)	217

Notes to the financial statements continued

34. Sensitivity analysis continued

Interest rate risk - earnings	30/06/20				
	Carrying amounts	-1% Net profit	+1% Net profit	-1% Equity	+1% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	492	(4)	4	(4)	4
Due from related parties	77	(1)	1	(1)	1
Due from other financial institutions	105	(1)	1	(1)	1
Investment securities	1,895	(14)	14	(14)	14
Derivative financial instruments	434	39	(39)	39	(39)
Loans and advances	22,222	(162)	162	(162)	162
Other financial assets	27	-	-	-	-
Total financial assets	25,252	(143)	143	(143)	143
Financial liabilities					
Due to other financial institutions	317	3	(3)	3	(3)
Due to related parties	7	-	-	-	-
Deposits and other borrowings	20,597	147	(163)	147	(163)
Derivative financial instruments	400	(72)	72	(72)	72
Debt securities issued	2,229	13	(13)	13	(13)
Lease liabilities	97	-	-	-	-
Other financial liabilities	70	-	-	-	-
Subordinated debt	150	-	-	-	-
Total financial liabilities	23,867	91	(107)	91	(107)

Notes to the financial statements continued

34. Sensitivity analysis continued

Interest rate risk - earnings	30/06/19				
		-1%	+1%	-1%	+1%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	421	(4)	4	(4)	4
Due from related parties	85	(1)	1	(1)	1
Due from other financial institutions	71	(1)	1	(1)	1
Investment securities	1,176	(6)	6	(6)	6
Derivative financial instruments	358	60	(60)	60	(60)
Loans and advances	20,443	(153)	153	(153)	153
Other financial assets	25	-	-	-	-
Total financial assets	22,579	(105)	105	(105)	105
Financial liabilities					
Due to other financial institutions	126	1	(1)	1	(1)
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	155	(155)	155	(155)
Derivative financial instruments	343	(83)	83	(83)	83
Debt securities issued	2,078	11	(11)	11	(11)
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	-	-	-	-
Total financial liabilities	21,112	84	(84)	84	(84)

Notes to the financial statements continued

34. Sensitivity analysis continued

Currency risk	30/06/20				
	Carrying amounts	-10% Net profit	+10% Net profit	-10% Equity	+10% Equity
Dollars in millions					
Financial assets					
Cash and cash equivalents	492	7	(6)	7	(6)
Due from related parties	77	-	-	-	-
Due from other financial institutions	105	-	-	-	-
Investment securities	1,895	-	-	-	-
Derivative financial instruments	434	97	(88)	97	(88)
Loans and advances	22,222	1	(1)	1	(1)
Other financial assets	27	-	-	-	-
Total financial assets	25,252	105	(95)	105	(95)
Financial liabilities					
Due to other financial institutions	317	(8)	7	(8)	7
Due to related parties	7	-	-	-	-
Deposits and other borrowings	20,597	(9)	8	(9)	8
Derivative financial instruments	400	7	(7)	7	(7)
Debt securities issued	2,229	(87)	79	(87)	79
Lease liabilities	97	-	-	-	-
Other financial liabilities	70	-	-	-	-
Subordinated debt	150	-	-	-	-
Total financial liabilities	23,867	(97)	87	(97)	87

Notes to the financial statements continued

34. Sensitivity analysis continued

Currency risk	30/06/19				
		-10%	+10%	-10%	+10%
Dollars in millions	Carrying amounts	Net profit	Net profit	Equity	Equity
Financial assets					
Cash and cash equivalents	421	7	(6)	7	(6)
Due from related parties	85	-	-	-	-
Due from other financial institutions	71	-	-	-	-
Investment securities	1,176	-	-	-	-
Derivative financial instruments	358	77	(70)	77	(70)
Loans and advances	20,443	1	(1)	1	(1)
Other financial assets	25	-	-	-	-
Total financial assets	22,579	85	(77)	85	(77)
Financial liabilities					
Due to other financial institutions	126	(6)	5	(6)	5
Due to related parties	9	-	-	-	-
Deposits and other borrowings	18,240	(19)	17	(19)	17
Derivative financial instruments	343	30	(28)	30	(28)
Debt securities issued	2,078	(85)	77	(85)	77
Other financial liabilities	63	-	-	-	-
Subordinated debt	253	-	-	-	-
Total financial liabilities	21,112	(80)	71	(80)	71

35. Auditor's remuneration

Dollars in thousands	Year ended	Year ended
	30/06/20	30/06/19
Auditor's remuneration		
Audit and review of financial statements	938	967
Other services:		
Other assurance services ¹	7	59
Tax compliance services ²	-	30
Other services ³	83	74
Total Auditor's remuneration	1,028	1,130

¹ Other assurance services relate to a register compliance assurance and compliance with certain matters in the Trust Deed in respect of a controlled entity of Kiwibank. (2019: register compliance assurance and compliance with certain matters in the Trust Deed in respect of a controlled entity of Kiwibank, solvency statement relating to Kiwibank Subordinated Bonds and a controls assurance report).

² No tax compliance services were provided in the year ended 30 June 2020. (2019: Tax compliance services related to the review of tax returns and GST apportionment methodology).

³ Other services include agreed-upon procedures in respect of a controlled entity of Kiwibank, capital models integrity check and provision of independent Kiwibank whistle-blower services. (2019: agreed-upon procedures in respect of a controlled entity of Kiwibank, capital models integrity check and provision of Kiwibank whistle-blower services).

Notes to the financial statements continued

36. Capital expenditure commitments

Capital expenditure commitments contracted for as at 30 June 2020, but not provided for in these financial statements, total \$6.3m (30 June 2019: \$3.1m) and are analysed by expected maturity in note 33.

37. Contingent liabilities and credit 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. Contingent liabilities are not recognised in the balance sheet, but are disclosed unless the likelihood of payment is remote.

The Banking Group enters into lending arrangements with customers with loan commitments which are only recognised in the balance sheet as loans and advances when cash is advanced. Letters of credit and performance-related contingencies include transactions where the Banking Group is obliged to make payments to a third party if a customer fails to fulfil its obligations under a contract.

The Bank uncovered disclosure issues in relation to the Credit Contracts and Consumer Finance Act during the year ended 30 June 2019 and proactively discussed these issues with the Commerce Commission. As at 30 June 2020, the Bank has recognised a provision to reflect its current position within other liabilities (30 June 2019: previously no provision was recognised as the possible impact of the Commission's position could not be determined with any certainty). See note 40 for more details of the settlement with the Commerce Commission agreed on 27 August 2020.

Undrawn credit commitments as at the reporting date are as follows:

Dollars in millions	30/06/20	30/06/19
Letters of credit and performance-related contingencies	47	48
Loan commitments	3,780	3,363
Total undrawn credit commitments	3,827	3,411

38. Contingent assets

The Banking Group held insurance policies at the date of the 2016 Kaikoura earthquake that provided cover for Material Damage and Business Interruption. As at 30 June 2020, all claims for costs under these policies have been received and no further reimbursements are expected (30 June 2019: it was probable that the policies would enable the Banking Group to obtain a further reimbursement for various costs incurred as a result of the earthquake; however, there was insufficient information to form a reliable estimate of the financial effect).

39. Changes in accounting policies

This note explains the nature and effect of the changes in accounting policies for the Banking Group due to the adoption of NZ IFRS 16 *Leases* effective from 1 July 2019.

IMPACT OF ADOPTION OF NEW ACCOUNTING STANDARDS ON THE FINANCIAL STATEMENTS

NZ IFRS 16: *Leases*

Summary

NZ IFRS 16 *Leases* replaced guidance in NZ IAS 17 *Leases* and introduced a single, on-balance sheet accounting model for lessees that requires a lessee to recognise its right to use underlying leased assets as a right-of-use asset, and an obligation to make lease payments as a lease liability for all leases. There are recognition exemptions for short-term leases and leases of low-value items. The asset and liability are initially measured at the present value of non-cancellable lease payments and payments to be made in optional periods where it is reasonably certain that the option will be exercised.

NZ IFRS 16 has an impact on the accounting treatment of leases within operating expenses disclosed in the Banking Group's income statement. Lease payments that were previously recognised as expenses on a straight-line basis over the term of a lease have been replaced by a depreciation expense on the right-of-use asset and financing costs calculated on the outstanding balance of the lease liability that are included within interest expense in the income statement.

Depreciation and interest expense are expected to be higher earlier in the term of a lease than the equivalent lease expenses under NZ IAS 17. This will result in changes in certain expense and profit measures. The Banking Group's cash flow statement has also been impacted by the principal portion of the lease payments being reported as part of cash flows from financing activities rather than cash flows from operating activities.

Notes to the financial statements continued

39. Changes in accounting policies continued

Leasing activities

The Banking Group leases various office sites, branch sites, ATM sites and vehicles. The majority of leases are for branch and office property leases. Rental contracts are typically made for fixed periods but may have extension options. Lease terms are generally negotiated on an individual basis for property leases and on a group basis for vehicle leases.

The Banking Group also subleases a portion of certain shared sites to NZ Post. The subleasing income is recognised in the income statement. The Banking Group is not party to any finance leases.

Key judgements made by management

NZ IFRS 16 involves a greater use of judgement than the previous approach to accounting for leases under NZ IAS 17. The key judgements for the Banking Group are assessing whether an arrangement contains a lease, determining the terms of lease contracts with renewal and termination options, and the method applied to calculating Incremental Borrowing Rates that are used to discount future lease payments to present value in calculating the lease liability for each lease. The latter two are considered areas of significant judgement and are explained in more detail in note 28.

Impact of transition

On adoption of NZ IFRS 16, the Banking Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under NZ IAS 17. These liabilities were measured at the present value of the remaining lease payments, discounted using the incremental borrowing rate as of 1 July 2019. The Banking Group's weighted average Incremental Borrowing Rate applied to calculate lease liabilities on 1 July 2019 was 2.87%.

As permitted by the standard, the Banking Group measured the right-of-use asset at an amount equal to the lease liability on a lease-by-lease basis. The Banking Group has also elected not to reassess whether a contract is, or contains, a lease at the date of initial application.

The impact of transitional adjustments resulting from the adoption of NZ IFRS 16 has been applied retrospectively by adjusting the opening balance of right-of-use assets, lease liabilities, deferred taxation, other assets, other liabilities and reserves. The Banking Group has not restated comparatives as permitted by the standard. The change in accounting policy affected the following items in the balance sheet on 1 July 2019:

- Right-of-use assets – increase by \$83.6m
- Deferred taxation – decrease by \$0.3m
- Other assets – decrease by \$1.4m
- Lease liabilities – increase by \$83.6m
- Other liabilities – decrease by \$2.5m
- Reserves – increase by \$0.8m.

The following table is an extract of the financial statements summarising each financial statement line item that was adjusted on 1 July 2019 upon adoption of NZ IFRS 16 *Leases*.

Dollars in millions	30/06/19	Transitional adjustments	01/07/19
Assets			
Right-of-use assets	-	84	84
Deferred taxation	21	-	21
Other assets	34	(1)	33
Total assets	22,734	83	22,817
Liabilities			
Lease liabilities	-	84	84
Other liabilities	102	(2)	100
Total liabilities	21,185	82	21,267
Shareholder's equity			
Reserves	812	1	813
Total shareholder's equity	1,549	1	1,550
Total liabilities and shareholder's equity	22,734	83	22,817

Notes to the financial statements continued

39. Changes in accounting policies continued

Practical expedients applied

The Banking Group applied the following practical expedients in applying NZ IFRS 16 for the first time as permitted by the standard:

- Certain leases with a remaining lease term of less than 12 months as at 1 July 2019 were treated as short-term leases.
- Certain initial direct costs were excluded for the measurement of the right-of-use asset at the date of initial application.
- Hindsight was used in determining the lease term where the contract contains options to extend or terminate the lease upon adoption.
- Reliance on previous assessments of whether a lease contract is onerous.

Reconciliation of closing operating lease commitments to opening lease liability

Dollars in millions	01/07/19
Operating lease commitments as at 30 June 2019	94
Discounted using the lessee's incremental borrowing rate at 1 July 2019 (at a weighted average of 2.87%)	79
<i>Add/(deduct):</i>	
Short-term leases not recognised as a liability	-
Low-value leases not recognised as a liability	-
Adjustments as a result of different treatment of extension and termination options	5
Lease liability recognised as at 1 July 2019	84

Additional or amended disclosures as a result of adopting NZ IFRS 16 are included in the following notes:

- Note 3 – Interest income and expense;
- Note 6 – Operating expenses;
- Note 28 – Leases; and
- Note 29 – Equity.

40. Events subsequent to the reporting date

Perpetual capital bond distribution

On 27 August 2020, a perpetual capital bond distribution of \$1.5m was paid to Kiwi Capital Funding Limited.

COVID-19 pandemic update

Following the confirmation of further community spread of COVID-19 with unknown origin, the Government announced at midday on 12 August New Zealand's COVID-19 Alert Levels changed, with the Auckland region (Wellsford to Pukekohe) moving to Alert Level 3 and the rest of New Zealand moving to Alert Level 2. The Government has made further announcements advising the lockdowns will be extended. As described in note 9, the Banking Group's expected credit losses are sensitive to changes in future economic forecasts. The forecast assumptions applied at 30 June 2020 remain reasonable and incorporated the risk of further lockdowns and the related economic impacts on borrowers. Therefore, the recent changes in COVID-19 Alert Levels and implementation of further lockdowns in New Zealand did not result in changes in credit impairment provisions recognised as at 30 June 2020.

Commerce Commission settlement

On 27 August 2020, the Commerce Commission and Kiwibank agreed that Kiwibank would pay \$5.2m to customers to settle issues relating to Kiwibank's home loan variation policies, procedures and systems in the period before April 2019. A fuller announcement on the settlement will be made in due course. All amounts in relation to this matter were provided for in the year ended 30 June 2020.

Other material events

There were no other material events that occurred subsequent to the reporting date which require recognition or additional disclosure in these financial statements.

Capital adequacy and regulatory liquidity ratios

Kiwibank Limited (“**Kiwibank**” or the “**Bank**”) is subject to the capital adequacy requirements for registered banks as specified by the Reserve Bank of New Zealand (“**RBNZ**”). Following an internationally agreed framework (commonly known as Basel III) developed by the Basel Committee on Banking Supervision, the RBNZ has set minimum acceptable regulatory capital requirements and provided methods for estimating or measuring the risks incurred by the Bank. As a bank adopting the Standardised Approach under the Basel III regime, Kiwibank applies the RBNZ’s BS12 - *Guidelines on a Bank’s Internal Capital Adequacy Assessment Process (“ICAAP”)* as a basis for estimating adequate prudential capital and BS2A - *Capital Adequacy Framework (Standardised Approach)* for calculating regulatory capital requirements. In accordance with Kiwibank’s banking conditions of registration, Kiwibank applies the RBNZ’s Basel III framework.

Regulatory capital adequacy ratios are calculated by expressing capital as a percentage of risk-weighted exposures. As a condition of registration, the Banking Group must comply with the following minimum capital requirements set by the RBNZ:

- Total capital ratio must not be less than 8.0% of risk-weighted exposures.
- Tier 1 capital ratio must not be less than 6.0% of risk-weighted exposures.
- The Common Equity Tier 1 capital ratio is not less than 4.5%.
- Capital of the Banking Group must not be less than NZ\$30m.

Regulatory capital

The Basel III standards for bank capital distinguish between Tier 1 and Tier 2 capital. Tier 1 capital is permanently and freely available to absorb losses without the bank being obliged to cease trading, while Tier 2 capital generally only absorbs losses in a winding up. Within Tier 1 capital, Common Equity Tier 1 capital (“**CET 1**”) has greater loss-absorbing capability than the other Tier 1 instruments referred to as Additional Tier 1 capital (“**AT 1**”).

Capital ratios are used to define minimum capital requirements for each of: Common Equity Tier 1 capital, Tier 1 capital (CET 1 plus AT 1), and Total capital (Tier 1 plus Tier 2), as a percentage of risk-weighted assets. There are increasing constraints on capital distributions where a bank’s capital level falls within the buffer range. The following table shows the current capital ratio requirements and conservation buffers (as a percentage of risk-weighted assets).

Capital ratios

	The Banking Group	
	30/06/20	30/06/19
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	11.4%	12.4%
Tier 1 capital ratio	12.6%	13.7%
Total capital ratio	12.6%	14.5%
RBNZ minimum ratios		
Common Equity Tier 1 capital ratio	4.5%	4.5%
Tier 1 capital ratio	6.0%	6.0%
Total capital ratio	8.0%	8.0%
Buffer ratios		
Buffer ratio	4.6%	6.5%
Buffer ratio requirement	2.5%	2.5%

	Kiwibank Limited	
	30/06/20	30/06/19
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	11.1%	12.1%
Tier 1 capital ratio	12.2%	13.3%
Total capital ratio	12.2%	14.1%

Capital adequacy and regulatory liquidity ratios continued

Ordinary shares

The ordinary shares issued by the Bank, which are fully paid, are included within CET 1 capital. The material terms and conditions of the ordinary shares are:

- a) each share contains a single right to vote;
- b) there are no redemption, conversion or capital repayment options/facilities;
- c) there is no predetermined dividend rate;
- d) there is no maturity date; and
- e) there are no options to be granted pursuant to any agreement.

Perpetual capital bonds

The perpetual capital bonds, issued by the Bank on 27 May 2015, and which are fully paid, are included within Additional Tier 1 capital ("AT1"). The perpetual capital bonds are subordinate to other term subordinated debt and all other general liabilities of the Banking Group and are denominated in New Zealand dollars. The material terms and conditions are:

- a) the perpetual capital bonds constitute direct, perpetual, convertible, non-cumulative, unsecured, subordinated debt securities issued by Kiwibank;
- b) interest on the perpetual capital bonds is payable quarterly subject to the absolute discretion of Kiwibank;
- c) interest was paid on the perpetual capital bonds at a fixed rate of 7.25% until 27 May 2020 when it was reset to 3.985%, effective until the next reset date of 27 May 2025;
- d) interest is non-cumulative;
- e) the perpetual capital bonds may be required to be converted into ordinary shares of Kiwibank Limited (or written off if conversion into ordinary shares is not possible) if certain events occur;
- f) the perpetual capital bonds do not have a maturity date; however, subject to meeting certain conditions, Kiwibank may elect to make early repayment on a reset date, or following a regulatory event or a tax event. RBNZ changes to Kiwibank's conditions of registration on 2 April 2020 meant that Kiwibank was not permitted to repay the bonds on the first reset date of 27 May 2020; and
- g) the perpetual capital bonds are not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Convertible subordinated bonds

The convertible subordinated bonds, issued by the Bank on 6 June 2014 and which were fully paid, were included within Tier 2 capital as at 30 June 2019. On 15 July 2019, the first call date, the convertible subordinated bonds were repaid in full. The convertible subordinated bonds were subordinate to all other general liabilities of the Banking Group and were denominated in New Zealand dollars. The material terms and conditions were:

- a) the convertible subordinated bonds constituted direct, unsecured, subordinated debt obligations of Kiwibank;
- b) interest on the convertible subordinated bonds was payable semi-annually at an initial rate of 6.61% p.a. subject to the condition that Kiwibank and the Banking Group were solvent after each payment;
- c) the convertible subordinated bonds may have been required to be converted into ordinary shares of Kiwibank Limited (or written off if conversion into ordinary shares was not possible) if certain events had occurred;
- d) the convertible subordinated bonds had a maturity date of 15 July 2024; however, Kiwibank could elect to make early repayment on 15 July 2019 or any semi-annual interest payment date thereafter (this early repayment election was made at the first call date as noted above); and
- e) the convertible subordinated bonds were not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Risk-weighted exposures

Risk-weighted exposures are derived by assigning risk-weight percentages to certain material risk categories of exposures. These exposures are measured or estimated from: selected balance sheet assets; off-balance-sheet exposures and market contracts; and business unit net income.

Capital adequacy and regulatory liquidity ratios continued

The Bank's current Prudential capital requirements based on assessments of its material risk classes (commonly referred to as "Pillar I" risk classes under Basel III) can be summarised as follows:

- Credit risk – The vulnerability of the Banking Group's lending and investment portfolios to systemic counterparty default. The risk-based capital allocation is computed following the RBNZ Standardised Approach to Credit Risk methodology (BS2A).
- Market risk – The vulnerability of earnings to movements in interest rates and currency volatility. The risk-based capital allocation is computed following the RBNZ Standardised Approach to Market Risk (BS2A).
- Operational risk – The risk of loss, resulting from inadequate or failed internal processes (including legal risks), people and systems and from external events. The risk-based capital allocation is computed following the RBNZ Standardised Approach to Operational Risk methodology (BS2A).

Kiwibank's Board is ultimately responsible for capital adequacy and approves capital plans and establishes minimum internal capital levels and limits. These are higher than the regulatory minimum.

The capital adequacy tables on the following pages summarise the composition of regulatory capital and capital adequacy ratios for the year ended 30 June 2020. Throughout the period, Kiwibank and the Banking Group complied with both regulatory and internal capital adequacy requirements.

Regulatory capital

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

Dollars in millions	The Banking Group	
	30/06/20	30/06/19
Common Equity Tier 1 capital		
Issued and fully paid up share capital	737	737
Retained earnings (net of appropriations)	853	823
Accumulated other comprehensive income and other disclosed reserves ^{1,2}	(20)	(11)
Less deductions from Common Equity Tier 1 capital		
Intangible assets	(60)	(74)
Cash flow hedge reserve	44	22
Deferred tax assets	(43)	(21)
Receivables from affiliated insurance group	(1)	(1)
Total Common Equity Tier 1 capital	1,510	1,475
Additional Tier 1 capital		
Perpetual capital bonds ³	150	149
Total Additional Tier 1 capital	150	149
Total Tier 1 capital	1,660	1,624
Tier 2 capital		
Convertible subordinated bonds	-	100
Total Tier 2 capital	-	100
Total capital	1,660	1,724

¹Includes fair value reserve of \$24m. The fair value reserve includes the cumulative net change in the fair value of investment securities until the investment is derecognised or impaired.

²Includes cash flow hedge reserve of (\$44m). The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of foreign exchange and interest rate derivative contracts related to hedged forecasted transactions that have not yet occurred. The cash flow hedge reserve is not eligible for inclusion in capital under BS2A 7 (3)(c).

³Perpetual capital bonds are classified as debt of the Banking Group for financial reporting purposes.

Capital adequacy and regulatory liquidity ratios continued

On-balance sheet exposures

Dollars in millions	The Banking Group			
	30/06/20			
	Total exposure	Risk weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
On-balance sheet exposures				
Cash and gold bullion	62	0%	-	-
Sovereigns and central banks	1,286	0%	-	-
Multilateral development banks and other international organisations	390	0%	-	-
Public sector entities	25	20%	5	-
	-	100%	-	-
Banks	98	20%	20	2
	457	50%	229	18
Corporate	163	20%	33	3
	18	50%	9	1
	1,623	100%	1,623	130
Non-property investment residential mortgage loans				
<= 80% loan-to-value ratio ("LVR")	11,416	35%	3,996	320
80 <= 90% LVR	1,199	50%	600	48
90 <= 100% LVR	37	75%	28	2
> 100% LVR	149	100%	149	12
Non-property investment residential mortgage loans - Welcome home loans and lenders mortgage insured loans				
<= 80% LVR	316	35%	111	9
80 <= 90% LVR	342	35%	120	10
90 <= 100% LVR	24	50%	12	1
Property investment residential mortgage loans				
<= 80% LVR	6,501	40%	2,600	208
80 <= 90% LVR	97	70%	68	5
90 <= 100% LVR	42	90%	38	3
> 100% LVR	34	100%	34	3
Property investment residential mortgage loans - Welcome home loans and lenders mortgage insured loans				
<= 80% LVR	26	40%	10	1
80 <= 90% LVR	1	50%	1	-
Impaired assets	1	100%	1	-
Past due residential mortgages > 90 days	10	100%	10	1
	1	35%	-	-
Other past due assets	5	150%	8	1
Non-risk-weighted assets	537	0%	-	-
All other equity holdings	-	400%	1	-
Other assets	650	100%	650	52
Total on-balance sheet exposures	25,510		10,356	830

Capital adequacy and regulatory liquidity ratios continued

Off-balance-sheet exposures and market-related contracts

The Banking Group						
30/06/20						
Dollars in millions	Total exposure	Credit conversion factor	Credit equivalent amount	Average risk weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
Direct credit substitute	37	100%	37	98%	36	3
Performance-related contingency	10	50%	5	100%	5	-
Other commitments where original maturity is greater than one year	2,708	50%	1,354	51%	688	55
Other commitments that cancel automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	1,072	0%	-	0%	-	-
Market-related contracts: ¹						
a) Foreign exchange contracts	1,409	n/a	157	47%	74	6
b) Interest rate contracts	22,717	n/a	373	47%	175	14
c) CVA		n/a			127	10
Total off-balance-sheet exposures	27,953		1,926		1,105	88

¹ The credit equivalent amount for market-related contracts was calculated using the current exposure method.

Capital adequacy and regulatory liquidity ratios continued

Residential mortgages by loan-to-value ratio

Dollars in millions	The Banking Group		
	30/06/20		
	On-balance sheet	Off-balance sheet	Total
LVR 0% - 80%	18,270	1,000	19,270
LVR 80% - 90%	1,640	46	1,686
LVR 90% +	286	32	318
Total	20,196	1,078	21,274

The LVR classification above is calculated in compliance with the Order.

At 30 June 2020, of the loans with an LVR greater than 80%, \$360m relates to 'Welcome Home' loans, whose credit risk is mitigated by the New Zealand Crown (via underwriting by Housing New Zealand Corporation).

Reconciliation of mortgage-related amounts

Dollars in millions	The Banking Group
	30/06/20
Residential mortgages total on-balance-sheet exposures	20,196
Provision for credit impairment	40
Deferred arrangement fees	79
Gross residential mortgage loans per asset quality (note 10)	20,315
Residentially secured lending included within 'Other term lending'	(938)
Gross term loans – housing per loans and advances (note 8)	19,377

Credit risk mitigation

Dollars in millions	The Banking Group			
	30/06/20			
	Total value of on- and off-balance-sheet exposures covered by eligible collateral (after haircutting)	Total value of on- and off-balance-sheet exposures covered by guarantees or credit derivatives	Risk-weighted exposure	Minimum Pillar I capital requirement
Bank	(23,619)	-	(293)	(23)
	(23,619)	-	(293)	(23)

The Banking Group uses the comprehensive method to measure the mitigating effects of collateral.

Capital adequacy and regulatory liquidity ratios continued

Operational risk

Dollars in millions	The Banking Group 30/06/20	
	Implied risk-weighted exposure	Total operational risk capital requirement
Operational risk	1,464	117

Market risk

Dollars in millions	The Banking Group 30/06/20			
	Implied risk-weighted exposure		Aggregate capital charge	
	End of period	Peak end-of-day	End of period	Peak end-of-day
Interest rate risk	588	739	47	59
- of which relates to trading book	16	28	1	2
Foreign currency risk	3	13	-	1
Equity risk	-	-	-	-

The aggregate market risk exposure above is derived in accordance with BS2A.

The peak end-of-day aggregate capital charge is the maximum over the half-year accounting period at the close of each business day.

Total capital requirements

Dollars in millions	The Banking Group 30/06/20		
	Total exposure after credit risk mitigation	Risk-weighted exposure or implied risk-weighted exposure	Total capital requirement
Total credit risk plus equity	29,844	11,168	895
Operational risk	n/a	1,464	117
Market risk	n/a	591	47
Total Pillar I risk	n/a	13,223	1,059

Capital adequacy and regulatory liquidity ratios continued

Other material risk (Pillar II)

The Basel III capital adequacy regime intends to ensure that banks have adequate capital to support all material risk inherent in their business activities. Consequently, banks are required to maintain an ICAAP for assessing overall capital adequacy in relation to their risk profile. Kiwibank's ICAAP methodology requires it to hold capital against the following 'other material risks' (Pillar II risks), including:

- Earnings risk – The current or prospective risk to earnings and growth targets arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.
- Other risks – Including conduct and culture, project execution, and cyber risks.

The Bank has made an internal capital allocation of \$54m (30 June 2019: \$63m).

Regulatory liquidity ratios

The Bank calculates regulatory liquidity ratios in accordance with the RBNZ's 'Liquidity Policy' (BS13). Ratios are calculated daily and the quarterly averages of each daily ratio are disclosed below.

	Three months ended 30/06/20	Three months ended 31/03/20
Average one-week mismatch ratio	9.3%	7.5%
Average one-month mismatch ratio	9.7%	7.4%
Average core funding ratio	91.4%	88.6%

Conditions of registration

The conditions of registration imposed on Kiwibank Limited by the Reserve Bank of New Zealand (“RBNZ”) pursuant to section 74 of the Reserve Bank of New Zealand Act 1989, which were applicable as at 30 June 2020, are as follows:

Conditions of registration for Kiwibank Limited

These conditions apply on and after 1 May 2020.

The registration of Kiwibank Limited (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 \$30m;
- 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 RBNZ; and
- f) the Bank meets the requirements of Part 3 of the RBNZ document entitled “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:

- “Total capital ratio”, “Tier 1 capital ratio”, and “Common Equity Tier 1 capital ratio” have the same meaning as in Part 3 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- “Total capital” has the same meaning as in Part 2 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) 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 entitled “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 entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015; and
- c) the Bank determines an internal capital allocation for each identified and measured “other material risk”.

1B. 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:

The 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 RBNZ for restoring the buffer ratio; and
- c) have the capital plan approved by the RBNZ.

For the purposes of this condition of registration:

- an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8.2(a) or (c) of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;
- “buffer ratio”, “distributions” and “earnings” have the same meaning as in Part 3 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015.

Conditions of registration continued

- 1C. That the Bank must make no distributions, whether paid out of earnings, or out of accumulated previous years' retained earnings or other reserves included within the Banking Group's total capital, other than discretionary payments payable to holders of Additional Tier 1 capital instruments to the extent permitted by condition 1B.

For the purposes of this condition of registration:

- an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8.2(a) or (c) of the RBNZ's document entitled "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015;
- "total capital" has the same meaning as in Part 2 of the RBNZ's document entitled "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015;
- "distributions" and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

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

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

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

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

- 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 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

¹This table uses the rating scales of S&P, Moody's and Fitch. (Fitch's scale is identical to S&P'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 RBNZ's document entitled "Connected Exposure 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.

Conditions of registration continued

6. That the Bank complies with the following corporate governance requirements:
- the board of the Bank must have at least five directors;
 - the majority of the board members must be non-executive directors;
 - at least half of the board members must be independent directors;
 - an alternate director:
 - for a non-executive director must be non-executive; and
 - for an independent director must be independent;
 - at least half of the independent directors of the Bank must be ordinarily resident in New Zealand;
 - the chairperson of the board of the Bank must be independent; and
 - the Bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the Bank).

For the purposes of this condition of registration, "non-executive" and "independent" have the same meaning as in the RBNZ's 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:
- the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - the RBNZ 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:
- the RBNZ has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - the RBNZ 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:
- the mandate of the committee must include ensuring the integrity of the Bank's financial controls, reporting systems and internal audit standards;
 - the committee must have at least three members;
 - every member of the committee must be a non-executive director of the Bank;
 - the majority of the members of the committee must be independent; and
 - 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 RBNZ's 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 has legal and practical ability to control and execute any business, and any functions relating to any business, of the Bank that are carried out 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:
- that the Bank's clearing and settlement obligations due on a day can be met on that day;
 - that the Bank's financial risk positions on a day can be identified on that day;
 - that the Bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
 - 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 24, from which point in time condition 24 will apply to that outsourcing arrangement.

For the purposes of this condition of registration:

- the term "legal and practical ability to control and execute" is explained in the RBNZ's document entitled "Outsourcing Policy" (BS11) dated January 2006; and
- the term "existing outsourcing arrangement" is defined in the RBNZ's document entitled "BS11: Outsourcing Policy for Registered Banks" dated April 2020.

Conditions of registration continued

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 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 0% at the end of each business day;
- b) the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day; and
- c) the one-year core funding ratio of the Banking Group is not less than 50% 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 RBNZ's documents entitled "Liquidity Policy" (BS13) dated January 2018 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated October 2018.

14. 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.

15. That no more than 10% of total assets may be beneficially owned by an 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 an SPV, and investors retain an unsecured claim on the issuer.

16. 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 RBNZ 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 RBNZ of the intended acquisition or business combination, the Bank provided the RBNZ with the information required under the RBNZ's Banking Supervision Handbook document entitled "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 RBNZ in writing of the intended acquisition or business combination;
 - ii) at the time of notifying the RBNZ of the intended acquisition or business combination, the Bank provided the RBNZ with the information required under the RBNZ's Banking Supervision Handbook document entitled "Significant Acquisitions Policy" (BS15) dated December 2011; and
 - iii) the RBNZ 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 RBNZ's Banking Supervision Handbook document entitled "Significant Acquisitions Policy" (BS15) dated December 2011.

Conditions of registration continued

17. That the Bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the RBNZ, the Bank can:
- a) close promptly at any time of the day and on any day of the week and that effective on 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 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 RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

18. That the Bank has an Implementation Plan that:
- a) is up to date; and
 - b) demonstrates that the Bank's pre-positioning for Open Bank Resolution meets the requirements set out in the RBNZ's document entitled "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 RBNZ document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

19. 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 by the RBNZ; and
 - c) if the RBNZ's agreement is conditional, meets the RBNZ'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 RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

20. 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 RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

21. That the Bank must comply with the RBNZ's document entitled "Outsourcing Policy" (BS11) dated April 2020.

In these conditions of registration:

- "Banking Group" means Kiwibank Limited (as a 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.

Non-compliance with conditions of registration

As previously reported, the Bank has been undertaking a review of its compliance with its conditions of registration. That review has now been concluded and the results are being discussed with the RBNZ. Any further updates will be disclosed as appropriate. Kiwibank is implementing a number of system and process improvements following the review.

As previously reported, in the year ended 30 June 2020 the Bank:

- identified a number of minor errors in its calculations of the regulatory liquidity ratios required under conditions of registration 13. The errors impacted regulatory ratio calculations but the Bank has remained above all Board and RBNZ ratio requirements at all times. These issues were remediated during the year ended 30 June 2020. The largest impact on the one-week and one-month mismatch ratios was in October 2019 and reduced the ratios by 12 basis points. The largest impact on the core funding ratio was in August 2019 and reduced the ratio by 8 basis points; and
- overlooked entering some outsourcing arrangements in the compendium, as required by condition of registration 21, for the period commencing from 1 October 2019. The Bank remediated this issue in January 2020.

The Bank has also identified that it was not fully compliant with condition of registration 17 which relates to the RBNZ's "Open Bank Resolution Policy" (BS17), as it was not pre-positioned to close the Bank in respect of one new channel and to partially freeze any liabilities within a new credit card book. Both matters were remedied by 30 June 2020. In addition, between August 2017 and May 2020 the Bank was not fully compliant with condition of registration 20 as processes to close one outsourced system for two low-value liability products were not tested. The system was included in the Bank's June 2020 test.

Conditions of registration continued

Changes in conditions of registration

The RBNZ issued revisions to the conditions of registration imposed on Kiwibank Limited effective from 2 April 2020 and 1 May 2020.

The new conditions from 2 April 2020:

- added restrictions on payments of dividends on ordinary shares and removed the ability to make distributions other than in relation to certain Additional Tier 1 instruments;
- extended the timeframe for complying with BS11: Outsourcing to six years; and
- reduced the minimum requirement for the core funding ratio from 75% to 50%.

The new conditions from 1 May 2020:

- removed restrictions on high loan-to-valuation ratio residential mortgage lending.



Independent auditor's report

To the readers of Kiwibank Limited's financial statements for the year ended 30 June 2020

This report is for the Banking Group, comprising Kiwibank Limited (the 'Bank'), its New Zealand domiciled subsidiaries and the other entities it controlled at 30 June 2020 or from time to time during the financial year.

The Auditor-General is the auditor of Kiwibank Limited (the 'Bank') and the Banking Group (the 'Banking Group'). The Auditor-General has appointed me, Michele Embling, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Banking Group on his behalf.

This report includes:

- our audit opinion on the financial statements prepared:
 - in accordance with Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'); and
 - in compliance with generally accepted accounting practice in New Zealand in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').

The financial statements comprise:

- the balance sheet as at 30 June 2020;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the cash flow statement for the year then ended; and
- the notes to the financial statements, which include significant accounting policies.
- our audit opinion on the supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) for the year ended 30 June 2020 prepared in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order;
- our audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- our review conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements prepared in accordance with Schedule 9 of the Order.

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

Our audit opinion

In our opinion:

- The Banking Group's financial statements (excluding the supplementary information):
 - (i) comply with generally accepted accounting practice in New Zealand;
 - (ii) comply with NZ IFRS and IFRS; and
 - (iii) present fairly, in all material respects, the financial position of the Banking Group as at 30 June 2020, and its financial performance and cash flows for the year then ended.



- The supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and included in the balance sheet and notes 10, 11, 12, 31, 33, 34 of the financial statements and within the capital adequacy and regulatory liquidity disclosures on page 116:
 - (i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
 - (ii) is in accordance with the books and records of the Banking Group; and
 - (iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Basis for audit opinion

We conducted our audit in accordance with the Auditor-General’s Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. 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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Banking Group in accordance with the Auditor-General’s Auditing Standards, which incorporate Professional and Ethical Standard 1: *International 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.

Our firm carries out other services for the Banking Group. These services are audit related agreed-upon procedure engagements in respect of a controlled entity of the Bank, register compliance assurance and compliance with certain matters in the Trust Deed in respect of a controlled entity of the Bank, capital model integrity check and provision of independent whistle-blower services. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. We have no other interests in the Banking Group.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How our audit addressed the Key Audit Matter
<p><i>Provision for credit impairment</i></p> <p>As detailed in note 8 to the financial statements, the Banking Group has loans and advances totalling \$22,222 million. These are net of provision for credit impairment of \$86 million which includes both individually assessed and collectively assessed provisions for credit impairment.</p>	<p>We developed an understanding of the controls implemented by management over the ECL impairment model and assessed whether they were appropriately designed and operating effectively throughout the year on a sample basis.</p>



Key Audit Matter	How our audit addressed the Key Audit Matter
<p>The provisions for credit impairment are determined using an expected credit loss (ECL) impairment model which takes into account forward-looking information reflecting potential future economic events.</p> <p>Loans and advances that exceed specific thresholds are individually assessed by management. If an individually assessed loan and advance is not impaired, it is then included in a group of loans and advances with similar risk characteristics and, along with those loans and advances below the specific thresholds referred to above, is collectively assessed on a portfolio basis using the ECL models developed by management.</p> <p>The Banking Group’s models are reliant on large volumes of data as well as a number of estimates including the impact of multiple economic scenarios, definition of significant increase in credit risk and other assumptions.</p> <p>We considered this a key audit matter due to the subjective judgements made by the Banking Group in determining the timing of recognition and the level of allowances for expected credit losses including:</p> <ul style="list-style-type: none"> • Models used to calculate ECLs (ECL models) are inherently complex and judgement is applied in determining the appropriate construct of the models to be applied, the determination of a significant increase in credit risk and the level of additional provision overlay required to estimate impairments due to potential loss events that could occur / have occurred but where those impacts are not yet incorporated into the ECL models; and • A number of assumptions are made by the Banking Group concerning the appropriateness of inputs to the ECL models and how inputs correlate with one another. <p>Further, the rapidly developing COVID-19 pandemic has meant assumptions regarding economic outlook and the consequent impact on the Banking Group’s customers is</p>	<p>For a sample of individually assessed credit impaired assets, we</p> <ul style="list-style-type: none"> • Understood the latest circumstances of the borrowers and the basis of measuring the credit impairment and considered whether the key judgements were appropriate given the borrowers’ circumstances and the impact of COVID-19; and • Considered, in relation to testing of collateral valuations, whether valuations were up to date and consistent with the strategy being followed in respect of the particular borrower. <p>For the collectively assessed impaired assets, where credit impairment is calculated using models, we engaged our own actuarial expert and performed the following procedures:</p> <ul style="list-style-type: none"> • Assessed the ECL model methodology and approach taken by the Banking Group against the requirements of accounting standards and the results of model monitoring performed; • Considered the Banking Group’s judgements including the reasonableness of forward-looking information incorporated into the ECL models by assessing the forecasts, assumptions and probability weightings applied in the multiple economic scenarios against current market conditions and other available evidence, with a particular focus on the impact of COVID-19; • On a sampling basis, agreed key data inputs to the ECL models to relevant source and underlying model documentation; • Recalculated the ECL model results for a sample of loans and advances; • For overlays to the modelled output, assessed the assumptions supporting the overlays and challenged management to provide evidence that the overlays were appropriate; • Performed a peer bank comparison and considered whether, with the inclusion of the overlays, the overall collective allowances for impairment sit within a range of acceptable outcomes; and • Considered the impact of events occurring subsequent to balance date on the ECL.



Key Audit Matter	How our audit addressed the Key Audit Matter
<p>uncertain, increasing the degree of judgement required to be exercised in calculating the ECL.</p> <p>Specifically, this includes judgements regarding the impact of COVID-19 on forward looking information, including variables used in macroeconomic scenarios, their associated weightings and the level of additional provision overlays required.</p> <p>See note 9 to the financial statements which explains the critical accounting estimates and judgements in determining the impairment of loans and advances.</p>	<p>We also assessed the appropriateness of the Banking Group's disclosures against the requirements of NZ IFRS.</p> <p>From the procedures performed we have no material matters to report.</p>
<p><i>Impairment testing of non-financial assets</i></p> <p>As disclosed in note 2.2 and note 25, the Banking Group has undertaken an impairment assessment of the carrying value of its non-financial assets as at 30 June 2020.</p> <p>The deterioration in economic conditions as a result of the COVID-19 pandemic lockdowns and border closures, and the consequential impact on the Bank are potential indicators of impairment. In addition, the shareholder of the Bank commissioned a valuation of the Banking Group, on a basis different to that required for the impairment test at the Banking Group level, that provided a further indication of impairment.</p> <p>Management consequently performed an impairment assessment for the Banking Group on a fair value less costs of disposal basis. The recoverable value of the Banking Group was determined with reference to both price to earnings and net tangible assets multiples, both derived from market observable data.</p> <p>This was considered to be a key audit matter due to the value of the non-financial assets, the risk of impairment arising from deteriorating economic conditions, and the significant level of judgement applied in estimating future sustainable earnings and other key assumptions in determining the recoverable amount of the Banking Group.</p>	<p>We obtained an understanding of the Banking Group's impairment assessment processes including management's identification of appropriate market data, determination of key valuation assumptions, and their consideration of the valuation commissioned by the shareholder of the Bank. We also considered the review and approval of the impairment assessment by management and the Board.</p> <p>We have performed a retrospective review of the past forecast achievement.</p> <p>We obtained management's impairment assessments and assessed the reasonableness of adjustments made to current year earnings to derive maintainable earnings, and recalculated net tangible assets.</p> <p>We engaged an Auditor's valuation expert to:</p> <ul style="list-style-type: none"> - independently obtain observable market data regarding price to earnings and net tangible assets multiples to assist us in challenging management's assessment and in forming our own independent assessment of an acceptable range of recoverable values for the Banking Group. - consider the basis of the valuation commissioned by the shareholder of the Bank and whether the differences between this valuation and management's valuation of the Banking Group would impact the conclusions reached. <p>We also assessed the appropriateness of the Banking Group's disclosures against the requirements of NZ IFRS.</p> <p>From the procedures performed we have no material matters to report.</p>



Key Audit Matter	How our audit addressed the Key Audit Matter
<p data-bbox="256 483 767 544"><i>Operation of Information Technology (IT) systems and controls</i></p> <p data-bbox="256 546 804 703">The Banking Group’s operations and financial reporting processes are heavily reliant on IT systems, including automated processes and controls over the processing and recording of significant volumes of transactions.</p> <p data-bbox="256 723 815 972">In considering the complexity of the Banking Group’s processes and the design of the internal control environment, there are certain areas of the audit where we seek to place reliance on automated controls or reports. The effective operation of these areas is dependent on the Banking Group’s IT General Control environment.</p> <p data-bbox="256 992 416 1021">For example:</p> <ul data-bbox="264 1041 815 1388" style="list-style-type: none"><li data-bbox="264 1041 815 1167">• change management internal controls are important because they help ensure that changes to applications and data are authorised and made appropriately;<li data-bbox="264 1187 815 1279">• IT operations are important as they help ensure errors in processing are resolved in a timely manner; and<li data-bbox="264 1299 815 1388">• user access controls are important to help ensure staff have appropriate access to IT systems and that access is monitored.	<p data-bbox="847 483 1485 640">For significant financial statement transactions and balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those transactions and balances.</p> <p data-bbox="847 660 1469 887">Where relevant to our planned audit approach, we validated the design and operating effectiveness of the key controls that support the continued integrity of the IT systems relevant to financial reporting together with tests of system-generated reports for the financial reporting period. We paid particular attention to the COVID-19 lockdown period.</p> <p data-bbox="847 907 1437 1064">Where we identified deficiencies in the design or operating effectiveness of those key controls, we performed additional and / or alternative audit procedures and communicated the deficiencies to management and those charged with governance.</p> <p data-bbox="847 1084 1469 1135">From the procedures performed we have no material matters to report.</p>

Our audit approach

Overview



An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement.

The overall Banking Group materiality was \$6 million which represents 5% of a weighted average profit before taxation for the years ended 30 June 2018, 30 June 2019 and 30 June 2020.

We chose profit before taxation as the benchmark because, in our view, it is the benchmark against which the performance of the Banking Group is most commonly measured by readers and is a generally accepted benchmark. We averaged the last three years profit before taxation due to the significant one-off impact of COVID-19 on the measure for the year ended 30 June 2020, with higher weighting applied to the most recent result.

We chose 5% based on our professional judgement, noting that it is also within the range of commonly accepted profit-related thresholds.

The following have been determined as Key Audit Matters:

- Provision for credit impairment
- Impairment testing of non-financial assets
- Operation of Information Technology (IT) systems and controls

Where these key audit matters are affected by the economic uncertainty created by the COVID-19 pandemic, then these uncertainties have been reflected in management's approach and our audit procedures, as described in the key audit matters.

Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Banking Group materiality for the financial statements as a whole as set out above. We also assess qualitative materiality, which includes other matters that, in our judgement, and in the context of our audit, might influence the economic decisions of the readers of the financial statements. Quantitative materiality and qualitative considerations helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Audit scope

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

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



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

The Directors of the Bank (the 'Directors') are responsible, on behalf of the Bank, for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order included on pages 1 to 8 and on pages 119 to 124. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon.

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

Responsibilities of the (excluding 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 financial statements in accordance with Clause 24 of the Order, NZ IFRS and IFRS 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 for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

In preparing the 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 to cease operations, or have no realistic alternative but to do so.

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)

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 111 to 118) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 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 the Auditor-General's Auditing Standards 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 readers taken on the basis of these financial statements.



As part of an audit in accordance with the Auditor-General's Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Banking Group's internal control;
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;
- Conclude on the appropriateness of the use of the going concern basis of accounting by the Directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Banking Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Banking Group to cease to continue as a going concern;
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Banking Group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Banking Group audit. We remain solely responsible for our opinion.

We communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.

We also provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards. From the matters communicated with the Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Our responsibilities arise from the Public Audit Act 2001.



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 financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 111 to 118) for the year ended 30 June 2020:

- (i) we have obtained all the information and explanations that we have required; and
- (ii) in our opinion, proper accounting records have been kept by the Banking Group as far as appears from an examination of those records.

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

We have examined the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 9 of the Order as disclosed on pages 111 to 118 of the Disclosure Statement of the Banking Group for the year ended 30 June 2020.

Our 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 on pages 111 to 118, is not, in all material respects, prepared in accordance with the Bank's conditions of registration and disclosed in accordance with Schedule 9 of the Order.

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

Basis for our conclusion

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410).

Our responsibilities under this standard are further described in the *Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements* section of our report.

Responsibilities of the Directors 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 that is prepared in accordance with the Bank's conditions of registration and disclosed in accordance with Schedule 9 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 review of 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 on pages 110 to 117 of the Disclosure Statement, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.



A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 111 to 118 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 the Auditor-General's Auditing Standards, which incorporate the 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 on pages 111 to 118 .

A handwritten signature in black ink, appearing to read 'Michele Embling', written over a circular scribble.

Michele Embling
On behalf of the Auditor-General
Wellington, New Zealand

28 August 2020

A handwritten signature in black ink that reads 'PricewaterhouseCoopers' in a cursive style.

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