Bank of New Zealand

U.S. Debt Funding Information

For the year ended September 30, 2019

Contents

Presentation of Information

Basis of Presentation

Bank of New Zealand's financial reporting group consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes (together, the "Banking Group"). The consolidated financial statements of the Banking Group are prepared in accordance with generally accepted accounting practice in New Zealand ("NZ GAAP"), the New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), International Financial Reporting Standards ("IFRS") and interpretations adopted by the International Accounting Standards Board ("IASB").

Certain differences exist between accounting principles generally accepted in the United States of America ("US GAAP") and NZ GAAP, NZ IFRS, IFRS and interpretations adopted by the IASB which might be material to the financial information presented in this document. The Banking Group has not prepared a reconciliation of its consolidated financial statements and related notes to the financial statements between NZ GAAP, NZ IFRS and US GAAP. In making an investment decision, investors must rely upon their own examination of the Banking Group, the terms of the offering and the financial information incorporated into the offering documents in connection with such offering. Potential investors should consult their own professional advisors for an understanding of these differences, and whether or not they affect the financial information presented in this document.

Information disclosed in this document is based on the Banking Group. It is different from the information disclosed under the New Zealand Banking segment ("NZ Banking") in the Annual Financial Report and Full Year Results of National Australia Bank Limited, the Banking Group's ultimate parent ("NAB"). NZ Banking excludes the group capital management and markets trading operations of the Banking Group and includes NAB's insurance operation in New Zealand.

The consolidated full year financial statements of the Banking Group are audited by an external auditor in accordance with International Standards on Auditing (New Zealand), which differ from those applicable in the United States.

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

Forward-Looking Statements

This document contains certain forward-looking statements within the meaning of Section 27A of the United States Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the United States Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this document are forward-looking statements.

The words "anticipate", "believe", "expect", "estimate", "likely", "should", "could", "may", "focus", "beyond", "aim" and other similar expressions are intended to identify forward-looking statements. Indications of, and guidance on, future earnings and financial position and performance are also forward-looking statements.

In this document, forward-looking statements may, without limitation, relate to statements regarding:

- economic and financial forecasts, including, but not limited to, statements in the business overview;
- anticipated implementation of certain control systems and programs, including, but not limited to, those described in the risk management section on page 19 herein; and
- certain plans, strategies and objectives of management.

Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Banking Group, which may cause actual results to differ materially from those expressed or implied in such statements contained in this document. For example:

- the economic and financial forecasts contained in this document will be affected by movements in interest and foreign currency exchange rates, which may vary significantly from current levels, as well as by general economic conditions in each of the Banking Group's major markets. Such variations may materially impact the Banking Group's financial condition and results of operations;
- the implementation of control systems and programs will be dependent on such factors as the Banking Group's ability to acquire or develop necessary technology or systems, its ability to attract and retain qualified personnel and the response of customers and third parties such as vendors; and
- the plans, strategies and objectives of management will be subject to, among other things, government regulation, which may change at any time and over which the Banking Group has no control. In addition, the Banking Group will continue to be affected by general economic conditions in New Zealand and worldwide, movements and conditions in capital markets, the competitive environment in each of its markets and political and regulatory policies.

Bank of New Zealand expressly disclaims any obligation or undertaking to update or revise in any manner any forward-looking statements contained in this document to reflect any changes in the expectations of Bank of New Zealand or the Banking Group with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

There can be no assurance that actual outcomes will not differ materially from the statements contained in this document.

Certain Definitions

The Banking Group's financial year ends on September 30. The financial year ended September 30, 2019 is referred to as 2019 and other financial years are referred to in a corresponding manner.

Some information in this document has been derived from the consolidated financial statements of the Banking Group. Where certain items are not shown in the Banking Group's consolidated financial statements, they have been prepared for the purpose of this document. Accordingly, this information should be read in conjunction with and is qualified in its entirety by reference to the Banking Group's audited consolidated financial statements, which are included in the Disclosure Statement for the year ended September 30, 2019. In addition, in connection with an offer of notes by BNZ, under BNZ's Rule 144A sub-program, which is associated with its US$100,000,000,000 Global Medium Term Note Program, this information should be read in conjunction with the offering circular supplement for such notes, including the consolidated financial statements of the Banking Group contained in the Disclosure Statements incorporated therein.

Presentation of Information

Certain Definitions *continued*

In this document, unless the context otherwise requires:

- references to “APRA” are to the Australian Prudential Regulation Authority;
- references to “Australian dollars” or “AUD” are to the lawful currency of Australia;
- references to “Banking Group” are to Bank of New Zealand’s financial reporting group, which consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes;
- references to “BNZ” or the “Bank” are to Bank of New Zealand;
- references to “BNZ-IF” are to BNZ International Funding Limited, a wholly owned entity of BNZ, acting through its London Branch;
- references to “CHF” are to the lawful currency of Switzerland and Liechtenstein;
- references to “Disclosure Statements” are to the disclosure statements the Banking Group prepared for the relevant period in compliance with Reserve Bank of New Zealand requirements, which contain consolidated financial statements of BNZ for the periods specified and have been published and filed with the Commission de Surveillance du Secteur Financier (the “CSSF”);
- references to “EUR” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Union as amended from time to time;
- references to “GBP” are to the lawful currency of the United Kingdom;
- references to “HKD” are to the lawful currency of Hong Kong Special Administrative Region of the People’s Republic of China;
- references to “JPY” are to the lawful currency of Japan;
- references to “NAB Group” are to NAB’s financial reporting group, which consists of NAB, all of its wholly owned entities and other entities consolidated for financial reporting purposes;
- references to “RBNZ” are to the Reserve Bank of New Zealand;
- references to “US$”, “USD” or “U.S. dollars” are to the lawful currency of the United States; and
- references to “$”, “New Zealand dollars”, “NZD”, “NZ$” or “NZ dollars” are to the lawful currency of New Zealand.

Uses of Internet Addresses

This document contains inactive textual addresses to internet websites. Reference to such websites is made for information purposes only, and information found at such websites is not incorporated by reference into this document.

Currency of Presentation and Exchange Rates

All currency amounts are expressed in New Zealand dollars unless otherwise stated. All amounts have been rounded to the nearest million dollars, except where indicated. Any discrepancies in the conversion between currencies contained in this document are due to rounding.

For the convenience of the reader, the selected financial information for the year ended September 30, 2019 has been translated from NZ dollars into U.S. dollars using the September 30, 2019 year end noon buying rate of USD 0.6262 = NZD 1.00.

Selected Financial Information

The selected financial information as at and for the years ended September 30, 2019, September 30, 2018, September 30, 2017, September 30, 2016 and September 30, 2015 has been derived from and should be read in conjunction with the consolidated financial statements and the related notes which are included in the Disclosure Statement for the year ended September 30, 2019. Where certain items are not shown in the consolidated financial statements contained therein, they have been prepared for the purpose of this document. Any discrepancies in the conversion between currencies in tables contained in this document are due to rounding.

Further details on the Banking Group's financial results for the year ended September 30, 2019 are provided in "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein and the Disclosure Statement for the year ended September 30, 2019.

The financial information in the Disclosure Statement for the year ended September 30, 2019 has been audited by external auditor, Ernst & Young, whose report on the audited financial statements is included in the Disclosure Statements for the year ended September 30, 2019.

The Disclosure Statement for the year ended September 30, 2019 has been prepared in accordance with NZ GAAP, NZ IFRS, IFRS and interpretations adopted by IASB. Certain differences exist between NZ GAAP, NZ IFRS, IFRS and interpretations adopted by IASB, and US GAAP, which might be material to the financial information.

Income Statement

			Consolidated			
	2019	**2019**	2018	2017	2016	2015
Dollars in Millions	**USD[1]**	**NZD**	NZD	NZD	NZD	NZD
Interest income	**2,627**	**4,195**	4,055	3,843	3,854	4,247
Interest expense	**1,336**	**2,134**	2,109	2,049	2,097	2,512
Net interest income	**1,291**	**2,061**	1,946	1,794	1,757	1,735
Gains less losses on financial instruments	**81**	**129**	191	118	106	322
Other operating income	**292**	**466**	419	403	406	375
Total operating income	**1,664**	**2,656**	2,556	2,315	2,269	2,432
Operating expenses	**711**	**1,135**	1,045	932	889	865
Total operating profit before credit impairment charge and income tax expense	**953**	**1,521**	1,511	1,383	1,380	1,567
Credit impairment charge	**71**	**114**	82	83	120	128
Total operating profit before income tax expense	**882**	**1,407**	1,429	1,300	1,260	1,439
Income tax expense on operating profit	**241**	**385**	400	363	347	401
Net profit attributable to shareholders of Bank of New Zealand	**641**	**1,022**	1,029	937	913	1,038

Performance Indicators

			Consolidated			
	USD[1]	**NZD**	NZD	NZD	NZD	NZD
Ordinary shares, fully paid (number of shares in millions)	**5,076**	**5,076**	4,476	3,371	3,371	3,371
Dividend per ordinary share (cents per share)[2]	**14.45**	**23.07[3]**	40.43[3]	20.77	14.83	11.01
Net profit per ordinary share (cents per share)	**12.61**	**20.13**	22.99	27.80	27.08	30.79
Return on assets[4]	**0.97%**	**0.97%**	1.03%	0.98%	1.01%	1.27%
Return on equity[5]	**13.10%**	**13.10%**	14.30%	13.39%	12.49%	15.71%
Cost to income ratio[6]	**42.73%**	**42.73%**	40.88%	40.26%	39.18%	35.57%

[1] For the convenience of the reader, the financial data for the year ended September 30, 2019 has been translated from NZ dollars into U.S. dollars using the September 30, 2019 year end noon buying rate of USD 0.6262 = NZD 1.00.

[2] Dividend paid divided by the weighted average number of ordinary shares outstanding during the year.

[3] On December 7, 2018, the Bank paid dividends of $945 million on its ordinary shares (December 8, 2017: $1,405 million) and issued 600 million ordinary shares (December 8, 2017: 1,105 million).

[4] Net profit after tax divided by total average assets.

[5] Net profit after tax divided by total average equity (total average equity calculated by total average assets minus total average liabilities).

[6] Operating expenses divided by total operating income.

Selected Financial Information

Balance Sheet

Dollars in Millions	2019 USD[1]	2019 NZD	Consolidated 2018 NZD	2017 NZD	2016 NZD	2015 NZD
Assets						
Cash and liquid assets	**1,716**	**2,740**	2,489	2,209	2,450	1,961
Due from central banks and other institutions	**898**	**1,434**	743	2,244	1,648	1,682
Trading securities	**4,551**	**7,267**	6,842	5,778	4,703	4,918
Derivative financial instruments	**4,769**	**7,616**	4,336	3,805	7,319	7,895
Loans and advances to customers	**55,131**	**88,041**	83,051	79,441	74,378	68,216
Amounts due from related entities	**385**	**615**	1,253	677	934	1,259
Other assets	**458**	**732**	557	520	549	369
Deferred tax	**123**	**197**	196	191	179	153
Property, plant and equipment	**111**	**177**	172	173	165	176
Goodwill and other intangible assets	**184**	**293**	352	277	216	158
Total assets	**68,326**	**109,112**	99,991	95,315	92,541	86,787
Financed by:						
Liabilities						
Due to central banks and other institutions	**1,148**	**1,833**	1,944	1,594	1,244	1,439
Trading liabilities	**57**	**91**	181	247	72	51
Derivative financial instruments	**3,823**	**6,106**	3,053	3,219	7,786	8,310
Deposits and other borrowings	**42,561**	**67,968**	63,437	59,912	57,511	51,756
Bonds and notes	**13,226**	**21,121**	19,760	20,157	16,723	16,156
Current tax liabilities	**50**	**80**	150	74	35	75
Amounts due to related entities	**525**	**838**	913	519	434	380
Other liabilities	**748**	**1,194**	1,228	828	809	863
Subordinated debt	**1,220**	**1,948**	1,946	1,824	922	715
Total liabilities	**63,358**	**101,179**	92,612	88,374	85,536	79,745
Net assets	**4,968**	**7,933**	7,379	6,941	7,005	7,042
Shareholders' equity						
Contributed equity – ordinary shares	**2,540**	**4,056**	3,456	2,351	2,351	2,351
Reserves	**62**	**99**	38	52	115	96
Retained profits	**2,366**	**3,778**	3,885	4,538	4,339	3,945
Ordinary shareholder's equity	**4,968**	**7,933**	7,379	6,941	6,805	6,392
Contributed equity – perpetual preference shareholders	**-**	**-**	-	-	200	650
Total shareholders' equity	**4,968**	**7,933**	7,379	6,941	7,005	7,042

Performance Indicators

	2019 USD[1]	2019 NZD	Consolidated 2018 NZD	2017 NZD	2016 NZD	2015 NZD
Loan to deposit ratio[2]	**1.40**	**1.40**	1.39	1.42	1.44	1.46

[1] For the convenience of the reader, the financial data for the year ended September 30, 2019 has been translated from NZ dollars into U.S. dollars using the September 30, 2019 year end noon buying rate of USD 0.6262 = NZD 1.00.

[2] Loans and advances to customers divided by Customer deposits (i.e., Deposits and other borrowings minus Short term debt securities (in "Active Funding Programs" on page 23)) for the year ended September 30, 2019. Prior to the September 30, 2017 Disclosure Statement, Customer deposits are disclosed as Deposits from customers in the balance sheet.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Prospective investors should read the following discussion of the Banking Group's financial condition and results of operations together with the Banking Group's audited consolidated full year financial statements and the notes to the respective financial statements which are included in the Disclosure Statement for the period specified. The presentation in this section contains forward-looking statements that involve risks, uncertainties and assumptions. The Banking Group's actual results may differ materially from those anticipated in such forward-looking statements as a result of a number of factors, including, but not limited to, those set forth under the caption "Risk Factors" in the offering circular supplement used in connection with an offer of notes under BNZ's Rule 144A sub-program which is associated with its US$100,000,000,000 Global Medium Term Note Program.

The following discussion is based on the audited consolidated full year financial statements of the Banking Group which have been prepared in accordance with NZ GAAP, NZ IFRS, IFRS and interpretations adopted by IASB. There are certain differences between US GAAP and NZ GAAP, NZ IFRS, IFRS and interpretations adopted by IASB which might be material to the financial information in this document. The following discussion is also prepared based on the Banking Group. It is different from the information disclosed under NZ Banking in the Annual Financial Report and Full Year Results of the NAB Group. NZ Banking excludes the group capital management and markets trading operations of the Banking Group and includes the NAB Group's insurance operation in New Zealand.

Overview

BNZ was incorporated on July 29, 1861 and its ultimate parent bank is NAB. The businesses and affairs of BNZ are managed by, or under the direction or supervision of, the BNZ Board of Directors ("BNZ Board") and the BNZ Chief Executive Officer ("CEO") in compliance with the requirements and regulations of the Banking Group's primary regulator, the RBNZ. BNZ is a registered bank under the Reserve Bank of New Zealand Act 1989 (the "Reserve Bank Act"). Further details on the supervisory role of the RBNZ are provided in "Supervisory Role of the RBNZ" on page 31 herein.

The Banking Group is one of New Zealand's largest banking organizations and provides a broad range of banking and financial products and services to retail, business, agribusiness, corporate and institutional clients.

The Banking Group's operations are affected by government actions, such as changes to taxation and government regulations, particularly those in New Zealand. The banking market in New Zealand is very competitive, which impacts the Banking Group's profitability in terms of interest rate spreads, lending and deposit volume growth and overall operating income.

Significant Conditions Affecting the Banking Group's Financial Condition and Results of Operations

The Banking Group continues to maintain a strong capital position, with a balance sheet that is supported by diversified and stable funding sources. As at September 30, 2019, the Banking Group's Common Equity Tier 1, Tier 1 and Total qualifying capital ratios were 10.97%, 12.32% and 13.93%, respectively, well above the RBNZ's minimum capital ratio requirements (including a 2.50% buffer ratio) of 7.00%, 8.50% and 10.50%, respectively. The Banking Group's capital ratios may be influenced by future market developments, such as regulatory changes, rating agency expectations and peer bank capital trends. The Banking Group's core funding ratio of 85.2% as at September 30, 2019, exceeded the RBNZ's minimum requirement of 75%.

The Banking Group maintains wholesale funding diversity by remaining active in both domestic and offshore markets, supporting the refinancing of term debt maturities. During the year ended September 30, 2019, the Bank issued senior unsecured medium term notes in USD, EUR, AUD and NZD.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies

Basis for preparation

The Banking Group's financial statements are prepared in accordance with the requirements of the New Zealand Financial Markets Conduct Act 2013, the New Zealand Registered Bank Disclosure Statement (New Zealand Incorporated Registered Banks) Order 2014 (as amended) and the Bank's accounting policies.

The financial statements have been prepared under the historical cost convention, modified by the application of fair value measurements required or allowed by relevant accounting standards.

Assumptions and estimates

The preparation of the financial statements requires the use of certain critical accounting estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. It also requires management to exercise judgement in the process of applying accounting policies. The notes to the financial statements include areas involving a higher degree of judgement or complexity, or areas where assumptions are significant to the Banking Group. Refer to Note 12 Provision for Credit Impairment and Note 25 Classification of Financial Instruments and Fair Value Measurement of the Disclosure Statement for the year ended September 30, 2019 for further information.

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

Reclassification of financial information

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

Changes in accounting policies and disclosures

New and amended accounting standards and interpretations

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

The Banking Group adopted New Zealand Equivalent to International Financial Reporting Standards ("NZ IFRS") 15 Revenue from Contracts with Customers ("NZ IFRS 15"). NZ IFRS 15 establishes a single principles-based five step model for recognizing revenue and introduces the concept of recognizing revenue when an obligation to a customer is satisfied. Adoption of this standard has not resulted in any significant impact on the Banking Group's reported results, financial position or disclosures.

New and amended accounting standards and interpretations not yet effective

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

- NZ IFRS 16 Leases ("NZ IFRS 16") significantly changes accounting for lessees, requiring recognition of all leases (subject to certain exceptions) on-balance sheet in a manner comparable to finance leases currently accounted under New Zealand Equivalent to International Accounting Standard ("NZ IAS") 17 Leases. The Banking Group will adopt NZ IFRS 16 from October 1, 2019. The Banking Group will apply NZ IFRS 16 using the modified retrospective transition option. All right-of-use assets will be measured with respect to the associated lease liability on the date of transition as opposed to measuring them as if NZ IFRS 16 had always been applied (often referred to as the simplified approach). The Banking Group will recognize approximately $252 million of right-of-use assets and $227 million of lease liabilities on transition. The difference of $25 million relates to make-good provisions recognized as part of the right-of-use asset but not the lease liability.
- New Zealand Equivalent to International Financial Reporting Interpretations Committee Interpretation ("NZ IFRIC") 23 Uncertainty over Income Tax Treatments clarifies the application of the recognition and measurement criteria in NZ IAS 12 Income Taxes where there is uncertainty over income tax treatments. The Banking Group will adopt NZ IFRIC 23 from October 1, 2019. The adoption is not expected to have a material impact on the Banking Group.
- In September 2019 the International Accounting Standards Board ("IASB") issued Interest Rate Benchmark Reform amending the hedge accounting requirements of NZ IFRS 9 Financial Instruments to avoid disruption to existing hedge accounting relationships directly impacted by the reform to benchmark interest rates. The amendments permit an entity to assume no impact to existing hedge accounting relationships subject to the reform, thereby allowing a continuation of hedge accounting. The IASB amendments are effective for annual periods beginning on or after January 1, 2020. The New Zealand Accounting Standards Board has issued the New Zealand equivalent to the amendment in November 2019.

The accounting policies used in the preparation of the financial statements are consistent with the accounting policies used in the preparation of the Disclosure Statement for the year ended September 30, 2019.

Principles of consolidation

Entities over which the Bank has the power to govern the financial and operating policies so as to obtain benefits from their activities are fully consolidated from the date on which control is transferred to the Bank. They are deconsolidated from the date that control ceases.

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

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

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

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

Management’s Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies *continued*

Net interest income recognition

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

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

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

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

Financial assets

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

Financial assets are classified into the following measurement categories:

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

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

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

Items at fair value through profit or loss include items held for trading and items specifically designated as fair value through profit or loss on initial recognition.

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

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

Financial assets held for trading

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

Financial assets designated at fair value through profit or loss

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

ii) Financial assets measured at amortized cost

A financial asset is measured at amortized cost only if:

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

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

Critical Accounting Policies *continued*

Impairment of financial assets

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

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

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

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

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

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

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

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

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

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

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

Financial liabilities

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

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

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

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

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

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

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

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

Management's Discussion and Analysis of Financial Condition and Results of Operations

Critical Accounting Policies *continued*

Financial liabilities *continued*

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

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

ii) Financial liabilities held at amortized cost

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

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Dollars in Millions	Consolidated 2019	2018	2017
Net interest income			
Interest income	**4,195**	4,055	3,843
Interest expense	**2,134**	2,109	2,049
Net interest income	**2,061**	1,946	1,794
Average interest earning assets	**97,135**	92,109	87,099
Net interest margin[1]	**2.12%**	2.11%	2.06%

[1] Net interest income divided by total average interest earning assets.

Net interest income 2019 vs 2018
Net interest income increased by $115 million or 5.9%, from $1,946 million in 2018 to $2,061 million in 2019. Net Interest income growth was mainly due to strong lending growth partially offset by the impact of the lower interest rate environment.

Average volumes of gross loans and advances to customers grew by $4,898 million or 6.0%, from $81,133 million in 2018 to $86,031 million in 2019. This was driven by growth in both the business and housing lending portfolios. Housing lending volume growth was supported by both the proprietary and broker channels.

Average volumes of deposits and other borrowings grew by $3,092 million or 4.9%, from $63,617 million in 2018 to $66,709 million in 2019. This was largely driven by an increase in deposits from customers, mainly due to an increase in average demand and term deposits for the year.

Overall, net interest margin increased by 1 basis point, from 2.11% in 2018 to 2.12% in 2019. The overall yield on total average interest earning assets decreased by 8 basis points, while the cost of total average interest bearing liabilities decreased by 7 basis points.

Key influences on the net interest margin result included:

- average yield on interest earning loans and advances to customers decreased by 12 basis points, from 4.79% in 2018 to 4.67% in 2019. The decrease was driven by a reduction in New Zealand swap rates in line with official cash rate reductions in May 2019 and August 2019;
- average cost of bonds and notes decreased by 18 basis points, from 2.92% in 2018 to 2.74% in 2019. This decrease was driven by lower wholesale interest rates; and
- average cost of interest bearing deposits and other borrowings decreased by 5 basis points, from 2.41% in 2018 to 2.36% in 2019. This decrease was largely due to decreasing New Zealand swap rates in line with official cash rate reductions in May 2019 and August 2019.

Net interest income 2018 vs 2017
Net interest income increased by $152 million or 8.5%, from $1,794 million in 2017 to $1,946 million in 2018. The increase was primarily driven by lending volume growth, lower deposit costs and lower term funding costs. This was partly offset by deposit volume growth and lower earnings on physical capital.

Average volumes of gross loans and advances to customers grew by $4,045 million or 5.2%, from $77,088 million in 2017 to $81,133 million in 2018. This was driven by growth in both the business and housing lending portfolios. Housing lending volume growth was supported by both the proprietary and broker channels.

Average volumes of deposits from customers (included within deposits and other borrowings) grew by $5,391 million or 9.9%, from $54,208 million in 2017 to $59,599 million in 2018. This was largely driven by an increase in deposits from customers, mainly due to an increase in average term deposits for the year.

Overall, net interest margin increased by 5 basis points, from 2.06% in 2017 to 2.11% in 2018. The overall yield on total average interest earning assets decreased by 1 basis point, while the cost of total average interest bearing liabilities decreased by 12 basis points.

Key influences on the net interest margin result included:

- average yield on interest earning loans and advances to customers increased by 2 basis points, from 4.77% in 2017 to 4.79% in 2018. The increase was largely due to lower swap costs associated with the early termination of fixed rate housing loans in the current year;
- average cost of bonds and notes decreased by 77 basis points, from 3.69% in 2017 to 2.92% in 2018. This decrease was mainly due to movements in NZD against other major currencies, a lower wholesale interest rate environment and maturity of certain bonds and notes at higher interest rates during the year; and
- average cost of interest bearing deposits and other borrowings increased by 9 basis points, from 2.32% in 2017 to 2.41% in 2018. This increase was largely due to increased rates on customer term deposits and commercial paper.

Dollars in Millions	Consolidated 2019	2018	2017
Gains less losses on financial instruments	**129**	191	118

Gains less losses on financial instruments 2019 vs 2018
Gains less losses on financial instruments decreased by $62 million or 32.5%, from a gain of $191 million in 2018 to a gain of $129 million in 2019. This was primarily due to unfavorable fair value movements on cross currency basis spreads on swaps used to economically hedge foreign currency fixed rate medium term notes.

Gains less losses on financial instruments 2018 vs 2017
Gains less losses on financial instruments increased by $73 million or 61.9%, from a gain of $118 million in 2017 to a gain of $191 million in 2018. This was largely driven by gains on cross currency basis spreads on swaps used to economically hedge foreign currency fixed rate medium term notes.

Results of Operations *continued*

Dollars in Millions	Consolidated 2019	2018	2017
Other operating income			
Money transfer fees	111	106	111
Fees earned on financial assets and liabilities	184	169	158
Other income, other fees and commissions income	171	144	134
Total other operating income	466	419	403

Other operating income 2019 vs 2018
Total other operating income increased by $47 million or 11.2%, from $419 million in 2018 to $466 million in 2019. Money transfer fees increased by $5 million, largely due to an increase in spend on BNZ cards and with BNZ merchants partially offset by the reduction and removal of certain fees charged to customers. Fees earned on financial assets and liabilities increased by $15 million largely due to increased annual line fee income. Other income increased by $27 million, primarily due to the gain on the sale of BNZ's 25% shareholding in Paymark Limited and a settlement in relation to the earthquake damage to BNZ's premises in Wellington.

Other operating income 2018 vs 2017
Total other operating income increased by $16 million or 4.0%, from $403 million in 2017 to $419 million in 2018. Money transfer fees decreased by $5 million, largely due to the reduction and removal of certain fees charged to customers during the year. Fees earned on financial assets and liabilities increased by $11 million largely due to increased annual line fee income and guarantee fees. Other income, other fees and commissions income increased by $10 million, including higher management fees from growth in funds under management.

Dollars in Millions	Consolidated 2019	2018	2017
Operating expenses			
Amortization and depreciation	254	111	96
Personnel expenses	521	537	493
Other operating expenses	360	397	343
Total operating expenses	1,135	1,045	932

Operating expenses 2019 vs 2018
Total operating expenses increased by $90 million or 8.6%, from $1,045 million in 2018 to $1,135 million in 2019. Amortization and depreciation increased by $143 million mainly due to $119 million one-off effect of accelerated amortization following a change in the BNZ software estimated useful life. Personnel costs decreased due to the non-repeat of the 2018 restructure provision partly offset by increased compliance spend. Other operating expenses decreased by $37 million, mainly due to the non-repeat of the 2018 restructure provision and cost efficiencies.

Operating expenses 2018 vs 2017
Total operating expenses increased by $113 million or 12.1%, from $932 million in 2017 to $1,045 million in 2018. Amortization and depreciation increased by $15 million associated with investment in infrastructure and systems. Personnel expenses increased by $44 million, largely due to a provision raised for restructure costs and increased salary costs. Other operating expenses increased by $54 million, largely due to increased investment management fees and continued investment in digital capabilities to enhance frontline efficiency and customer experience as well as increased compliance spend.

Dollars in Millions	Consolidated 2019	2018	2017
Credit impairment charge and credit risk adjustments on credit exposures			
Credit impairment charge	114	82	83
Credit risk adjustments on financial assets designated at fair value through profit or loss[1]	(5)	(11)	(20)
Total credit impairment charge and credit risk adjustments on credit exposures	109	71	63

[1] Disclosed within gains less losses on financial instruments in the income statement.

For financial reporting purposes, as required by NZ IFRS, credit risk adjustments on financial assets designated at fair value through profit or loss are disclosed within gains less losses on financial instruments in the income statement. The table above represents the Banking Group's total credit impairment charge and credit risk adjustments on credit exposures. Movements in credit impairment charge should be read in conjunction with movements in credit risk adjustments on financial assets designated at fair value through profit or loss.

Credit impairment charge and credit risk adjustments on credit exposures 2019 vs 2018
Total credit impairment charge and credit risk adjustments increased by $38 million or 53.5%, from $71 million in 2018 to $109 million in 2019. The increase in credit impairment charges was mainly driven by a small number of large corporate dairy customers.

Credit impairment charge and credit risk adjustments on credit exposures 2018 vs 2017
Total credit impairment charge and credit risk adjustments increased by $8 million or 12.7%, from $63 million in 2017 to $71 million in 2018. This was due to a collective provision forward-looking adjustment across certain sectors in the portfolio, partly offset by improved credit quality across all portfolios.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations *continued*

Dollars in Millions	Consolidated 2019	2018	2017
Assets			
Cash and liquid assets	**2,740**	2,489	2,209
Due from central banks and other institutions	**1,434**	743	2,244
Trading securities	**7,267**	6,842	5,778
Derivative financial instruments	**7,616**	4,336	3,805
Loans and advances to customers	**88,041**	83,051	79,441
Amounts due from related entities	**615**	1,253	677
Other assets	**732**	557	520
Deferred tax	**197**	196	191
Property, plant and equipment	**177**	172	173
Goodwill and other intangible assets	**293**	352	277
Total assets	**109,112**	99,991	95,315

Assets 2019 vs 2018
Total assets increased by $9,121 million or 9.1%, from $99,991 million in 2018 to $109,112 million in 2019, mainly due to growth in net loans and advances to customers of $4,990 million and an increase in derivatives of $3,280 million.

Net loans and advances to customers increased by $4,990 million or 6.0%, from $83,051 million in 2018 to $88,041 million in 2019. This was mainly driven by growth in housing loans of $3,156 million and business lending of $1,145 million.

Amounts due from related entities decreased by $638 million or 50.9%, from $1,253 million in 2018 to $615 million in 2019. This was mainly driven by a decrease in reverse repos held of $625 million.

Derivative financial instruments increased by $3,280 million or 75.6%, from $4,336 million in 2018 to $7,616 million in 2019. This increase was driven by the interest rate derivative portfolio as the gap between dealt and revaluation rates has widened and the depreciating NZD against other major foreign currencies.

Due from central banks and other institutions increased by $691 million or 93.0%, from $743 million in 2018 to $1,434 million in 2019. This was mainly driven by an increase of $784 million in collateral posted to meet standard derivative trading obligations.

Assets 2018 vs 2017
Total assets increased by $4,676 million or 4.9%, from $95,315 million in 2017 to $99,991 million in 2018, mainly due to growth in net loans and advances to customers of $3,610 million.

Net loans and advances to customers increased by $3,610 million or 4.5%, from $79,441 million in 2017 to $83,051 million in 2018. This was primarily driven by increases in housing loans of $2,369 million and business lending of $1,012 million.

Trading securities increased by $1,064 million or 18.4%, from $5,778 million in 2017 to $6,842 million in 2018. This was mainly driven by an increase in semi-government securities of $1,194 million for the purpose of liquidity management.

Amounts due from related entities increased by $576 million or 85.1%, from $677 million in 2017 to $1,253 million in 2018. This increase was mainly driven by an increase in securities purchased under agreements to resell of $685 million, offset by a decrease in collateral loan of $101 million.

Derivative financial instruments increased by $531 million or 14.0%, from $3,805 million in 2017 to $4,336 million in 2018. This increase was driven by depreciating NZD against other major foreign currencies.

Due from central banks and other institutions decreased by $1,501 million or 66.9%, from $2,244 million in 2017 to $743 million in 2018. This decrease was mainly driven by a decrease in term placements with other financial institutions of $1,282 million.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations *continued*

	Consolidated		
Dollars in Millions	2019	2018	2017
Liabilities			
Due to central banks and other institutions	**1,833**	1,944	1,594
Trading liabilities	**91**	181	247
Derivative financial instruments	**6,106**	3,053	3,219
Deposits and other borrowings	**67,968**	63,437	59,912
Bonds and notes	**21,121**	19,760	20,157
Current tax liabilities	**80**	150	74
Amounts due to related entities	**838**	913	519
Other liabilities	**1,194**	1,228	828
Subordinated debt	**1,948**	1,946	1,824
Total liabilities	**101,179**	92,612	88,374
Shareholder's equity			
Contributed equity – ordinary shares	**4,056**	3,456	2,351
Reserves	**99**	38	52
Retained profits	**3,778**	3,885	4,538
Total shareholder's equity	**7,933**	7,379	6,941

Liabilities and equity 2019 vs 2018
Total liabilities increased by $8,567 million or 9.3%, from $92,612 million in 2018 to $101,179 million in 2019, primarily due to growth in deposits and other borrowings of $4,531 million, an increase in derivative financial liabilities of $3,053 million and an increase in bonds and notes of $1,361 million.

Deposits and other borrowings increased by $4,531 million or 7.1%, from $63,437 million in 2018 to $67,968 million in 2019. This increase was mainly driven by an increase in demand deposits of $1,726 million, term deposits of $1,077 million and an increase in commercial paper of $1,687 million.

Bonds and notes increased by $1,361 million or 6.9%, from $19,760 million in 2018 to $21,121 million in 2019. This was primarily due to movements in NZD against other major trading currencies and interest rate movements.

Derivative financial liabilities increased by $3,053 million or 100.0%, from $3,053 million in 2018 to $6,106 million in 2019. This increase was driven by the interest rate derivative portfolio as the gap between dealt and revaluation rates has widened and the depreciating NZD against other major foreign currencies.

Total shareholder's equity increased by $554 million or 7.5%, from $7,379 million in 2018 to $7,933 million in 2019. The increase is mainly due to a $600 million increase in ordinary shares issued In December 2018 to National Australia Group (NZ) Limited ("NAGNZ") and $1,022 million of profits, offset by dividends paid of $1,145 million.

Liabilities and equity 2018 vs 2017
Total liabilities increased by $4,238 million or 4.8%, from $88,374 million in 2017 to $92,612 million in 2018, primarily due to growth in deposits and other borrowings of $3,525 million.

Deposits and other borrowings increased by $3,525 million or 5.9%, from $59,912 million in 2017 to $63,437 million in 2018. This increase was mainly driven by a $3,645 million growth in customer deposits to fund the growth in loans and advances to customers.

Total shareholder's equity increased by $438 million or 6.3%, from $6,941 million in 2017 to $7,379 million in 2018. The increase is mainly due to a $1,105 million increase in ordinary shares issued in December 2017 to NAGNZ, offset by a decrease in retained profits of $653 million.

Management’s Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations *continued*

Results of Operations by Segments

For segment reporting purposes, the Banking Group is organized into three major reportable and operating segments: Partnership Banking; Private, Wealth and Insurance; and Corporate and Institutional Banking. In 2019, there has been a structural realignment of the business units in the Banking Group. Previously, there were two major reportable and operating segments: ‘Consumer and Wealth’ and ‘BNZ Partners’, which have been changed to three segments ‘Partnership Banking’, ‘Private, Wealth and Insurance’ and ‘Corporate and Institutional Banking’. Comparative balances have been reclassified. The tables on pages 15 to 18 herein show the results of operations by each segment for 2019, 2018 and 2017.

Partnership Banking

Partnership Banking provides financial products and services to retail, business and corporate customers.

	Consolidated		
Dollars in Millions	**2019**	2018	2017
Net interest income	**1,758**	1,643	1,495
Other income	**300**	292	297
Total operating income	**2,058**	1,935	1,792
Operating expenses	**828**	799	738
Operating profit before credit impairment charge and income tax expense	**1,230**	1,136	1,054
Credit impairment charge	**80**	100	104
Operating profit before income tax expense	**1,150**	1,036	950
Total income tax expense	**322**	292	264
Net profit attributable to shareholders of Bank of New Zealand	**828**	744	686

Partnership Banking results of operations 2019 vs 2018

Partnership Banking net profit after tax increased by $84 million or 11.3%, from $744 million in 2018 to $828 million in 2019. This was largely driven by an increase in total operating income and lower impairment charges on credit exposures, partly offset by higher operating expenses.

Total operating income increased by $123 million or 6.4%, from $1,935 million in 2018 to $2,058 million in 2019. This was driven by growth in lending and deposit volumes.

Operating expenses increased by $29 million or 3.6%, from $799 million in 2018 to $828 million in 2019. This was largely driven by increased spend to strengthen the compliance and control environment combined with increased depreciation and amortization charges associated with investment in digital capabilities and process improvement, partially offset by productivity benefits.

Credit impairment charge reduced by $20 million or 20.0%, from $100 million in 2018 to $80 million in 2019. This was mainly driven by improved credit quality across most portfolios.

Partnership Banking results of operations 2018 vs 2017

Partnership Banking net profit after tax increased by $58 million or 8.5%, from $686 million in 2017 to $744 million in 2018. This was largely driven by an increase in total operating income offset by higher operating expenses.

Total operating income increased by $143 million or 8.0%, from $1,792 million in 2017 to $1,935 million in 2018. This was largely driven by growth in lending and deposit volumes.

Operating expenses increased by $61 million or 8.3%, from $738 million in 2017 to $799 million in 2018. This was largely due to increased depreciation and amortization associated with investment in infrastructure and systems and continued investment in digital capabilities to enhance frontline efficiency and customer experience.

Credit impairment charge reduced by $4 million or 3.8%, from $104 million in 2017 to $100 million in 2018. This decrease was primarily due to improved credit quality.

Results of Operations by Segments *continued*

Private, Wealth and Insurance

Private, Wealth and Insurance provides private banking, investment and insurance products and services to retail customers.

	Consolidated		
Dollars in Millions	2019	2018	2017
Net interest income	40	38	36
Other income	120	117	108
Total operating income	160	155	144
Operating expenses	79	76	66
Operating profit before credit impairment charge and income tax expense	81	79	78
Credit impairment charge	-	1	-
Operating profit before income tax expense	81	78	78
Total income tax expense	21	22	23
Net profit attributable to shareholders of Bank of New Zealand	60	56	55

Private, Wealth and Insurance results of operations 2019 vs 2018

Private, Wealth and Insurance net profit after tax increased by $4 million or 7.1%, from $56 million in 2018 to $60 million in 2019. This was largely driven by an increase in operating income and lower credit impairment charges, partly offset by higher expenses.

Total operating income increased by $5 million or 3.2%, from $155 million in 2018 to $160 million in 2019. This was largely driven by an increase in income from insurance activities.

Private, Wealth and Insurance results of operations 2018 vs 2017

Private, Wealth and Insurance net profit after tax increased by $1 million or 1.8%, from $55 million in 2017 to $56 million in 2018. This was largely driven by an increase in operating income, offset by an increase in operating expenses.

Total operating income increased by $11 million or 7.6%, from $144 million in 2017 to $155 million in 2018. This was largely due to increased revenue from private banking and wealth products.

Operating expenses increased by $10 million or 15.2%, from $66 million in 2017 to $76 million in 2018. This was largely due to increased depreciation and amortization associated with investment in infrastructure and systems and continued investment in digital capabilities to enhance frontline efficiency and customer experience.

Results of Operations by Segments *continued*

Corporate and Institutional Banking

Corporate and Institutional Banking provides financial products and services to corporate agribusiness and institutional customers.

Dollars in Millions	Consolidated		
	2019	2018	2017
Net interest income	**159**	152	162
Other income	**206**	175	166
Total operating income	**365**	327	328
Operating expenses	**90**	87	91
Operating profit before credit impairment charge and income tax expense	**275**	240	237
Credit impairment charge	**30**	(24)	(20)
Operating profit before income tax expense	**245**	264	257
Total income tax expense	**69**	74	72
Net profit attributable to shareholders of Bank of New Zealand	**176**	190	185

Corporate and Institutional Banking results of operations 2019 vs 2018

Corporate and Institutional Banking net profit after tax reduced by $14 million or 7.4%, from $190 million in 2018 to $176 million in 2019. This was largely driven by an increase in credit impairment charges as well as an increase in operating expenses, partly offset by an increase in operating income.

Total operating income increased by $38 million or 11.6%, from $327 million in 2018 to $365 million in 2019. This was largely due to increased income from increased lending volumes and improved margins, along with an increase in customer risk management activity.

Credit impairment charge increased by $54 million or 225.0%, from an impairment gain of $24 million in 2018 to an impairment charge of $30 million in 2019. This increase was primarily due to a reduction in credit quality of a small number of large corporate dairy customers.

Corporate and Institutional Banking results of operations 2018 vs 2017

Corporate and Institutional Banking net profit after tax increased by $5 million or 2.7%, from $185 million in 2017 to $190 million in 2018. This was largely driven by an increase in credit impairment gain.

Operating expenses reduced by $4 million or 4.4%, from $91 million in 2017 to $87 million in 2018. This was largely due to productivity benefits and cost discipline.

Credit impairment gain increased by $4 million or 20.0%, from an impairment gain of $20 million in 2017 to an impairment gain of $24 million in 2018. This increase was primarily due to improved credit quality.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations by Segments *continued*

Other Segment

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

	Consolidated		
Dollars in Millions	**2019**	2018	2017
Net interest income	**104**	113	101
Gains less losses on financial instruments[1]	**129**	191	118
Other income/(expense)	**(160)**	(165)	(168)
Total operating income	**73**	139	51
Operating expenses	**138**	83	37
Operating profit/(loss) before credit impairment charge and income tax expense	**(65)**	56	14
Credit impairment charge	**4**	5	(1)
Operating profit/(loss) before income tax expense	**(69)**	51	15
Total income tax expense	**(27)**	12	4
Net profit attributable to shareholders of Bank of New Zealand	**(42)**	39	11

[1] All gains less losses on financial instruments have been reported in the Other Segment.

Other Segment results of operations 2019 vs 2018

Net profit after tax for the Other Segment reduced by $81 million or 207.7%, from a profit of $39 million in 2018 to a loss of $42 million in 2019. This was largely driven by a decrease in gains less losses on financial instruments and an increase in operating expenses.

Gains less losses on financial instruments decreased by $62 million or 32.5%, from a gain of $191 million in 2018 to a gain of $129 million in 2019. This was primarily due to unfavorable fair value movements on cross currency basis spreads on swaps used to economically hedge foreign currency fixed rate medium term notes.

Operating expenses increased by $55 million or 66.3%, from $83 million in 2018 to $138 million in 2019. This was largely due to increased depreciation and amortization associated with an adjustment to the BNZ software estimated useful life.

Other Segment results of operations 2018 vs 2017

Net profit after tax for the Other Segment increased by $28 million or 254.5%, from $11 million in 2017 to $39 million in 2018. This was largely driven by a increase in gains less losses on financial instruments, partly offset by an increase in operating expenses.

Gains less losses on financial instruments increased by $73 million or 61.9%, from a gain of $118 million in 2017 to a gain of $191 million in 2018. This was largely driven by gains on cross currency basis spreads on swaps used to economically hedge foreign currency fixed rate medium term notes.

Operating expenses increased by $46 million or 124.3%, from $37 million in 2017 to $83 million in 2018. This was largely driven by an increase in restructure costs.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Risk Management

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

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

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

Bank of New Zealand is primarily regulated by the RBNZ and the Banking Group is subject to the prudential reporting requirements of APRA as part of the NAB Group. In addition, in connection with an offer of notes, an investor should carefully consider the risks set forth in or incorporated by reference into the applicable offering circular supplement.

The key risks faced by the Banking Group include:

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

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

Board governance

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

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

The BNZ Board determines the most appropriate corporate governance practices for the Banking Group and is supported by a number of committees. The Board Risk Committee ("BRC") supports the framework for risk management across the Banking Group. Further details on the role of BRC are on page 37 herein.

Executive governance

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

Internal audit function

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

NZRAC assists the BNZ Board to fulfill its statutory and fiduciary responsibilities relating to accounting and financial controls, reporting systems and processes of the Banking Group and to oversee the internal audit function. Further details on the role of NZRAC are on page 37 herein.

External auditor and credit rating agencies

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

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

Management of risk types

The management of certain categories of risk is described below, but there are other types of risk which may adversely impact the Banking Group's reputation or future prospects, including its financial performance or position. Other risks include, but are not limited to:

- a loss of accreditation or regulatory or other licensing for the Banking Group's operations causing the loss of contracts, customers or market share;
- a failure to address existing or new environmental, governance or social issues;
- the development of new services or technology in competition with the Banking Group; and
- new legislation or regulation which impacts the products and services being offered by the Banking Group or adds to compliance costs.

Risk Management *continued*

Management of risk types *continued*

Credit risk

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

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

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

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

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

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

Operational risk

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

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

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

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

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

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

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

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

Compliance risk

Compliance risk is the risk of legal or regulatory sanctions resulting from a failure to understand and comply with laws, regulations, licence conditions, supervisory requirements, and self-regulatory industry codes of conduct, as well as internal policies, procedures, frameworks and standards that support sustainability and provide protections to our customers. The Banking Group has adopted the NAB Group's Compliance Framework (Compliance Obligation Management Policy) which sets out the principles for managing compliance risk across the Banking Group.

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

Risk Management *continued*

Management of risk types *continued*

Conduct risk

Conduct risk is inherent in the Banking Group's business activities. Conduct risk is the risk of the Banking Group intentionally or unintentionally treating its customers unfairly and delivering negative outcomes for customers, employees, the community, other stakeholders and the markets in which the Banking Group operates resulting from inappropriate, unlawful or unethical judgements made during the execution of the Banking Group's business activities.

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

Market risk - traded

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

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

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

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

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

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

Market risk – non-traded/banking positions

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

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

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

Interest rate risk

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

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

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

Similar to the methodology applied for traded market risk provided in "Market Exposures" on page 28 herein, VaR is calculated using the historic simulation method. Due to the generally longer holding period for non-traded products, the parameters applied differ. The key parameters for measuring non-traded market risk are as follows:

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

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

Liquidity risk

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

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

Risk Management *continued*
Management of risk types *continued*
Liquidity risk *continued*
The following are types of liquidity risks:

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

The Banking Group manages liquidity risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets and maintenance of a prudent funding strategy. The Banking Group undertakes a conservative approach by imposing internal limits that are in addition to regulatory requirements.
Independent oversight of the Banking Group's non-traded market risk, including compliance with limits, is undertaken by the Balance Sheet and Liquidity risk team, which reports through to the Chief Risk Officer. Governance is provided by the Banking Group's Asset, Liability and Capital Committee ("ALCCO"), which is a subcommittee of the Banking Group's RRMC.

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

Further details of the Banking Group's risk management policies are provided in "Market Exposures" on page 28 herein and Note 34 Risk Management of the Disclosure Statement for the year ended September 30, 2019.

Liquidity, Funding and Capital Resources

Liquidity and Funding

The Banking Group complies with the liquidity requirements of the banking regulators in New Zealand and Australia (in the case of Australia, due to its status as a subsidiary of NAB). Liquidity within the Banking Group is also managed in accordance with internal policies approved by the BNZ Board, with oversight from ALCCO.

The Banking Group's liquidity policies are designed to ensure that sufficient cash balances and liquid asset holdings are maintained to meet the Bank's obligations as they fall due, in both ordinary market conditions and during periods of stress. These obligations include the repayment of deposits on demand or at their contractual maturity dates, the repayment of borrowings and loan capital as they mature, the payment of operating expenses and taxation, the payment of dividends to shareholders, and the ability to fund new and existing loan and contractual commitments.

Liquid assets are defined by the willingness of the RBNZ to accept them as collateral.

The Banking Group's principal sources of liquidity are:

- the maturity of marketable securities;
- interest and principal repayments received from customer loans;
- customer deposits;
- proceeds from commercial paper, certificates of deposit, bonds and notes;
- fee income;
- interest income and dividends from investments;
- security repurchase agreements with the RBNZ; and
- lending facilities.

The Banking Group holds sizeable balances of marketable treasury and other eligible bills and debt securities which could be disposed of to provide additional funding should the need arise. As at September 30, 2019, the Banking Group held $7,267 million (September 30, 2018: $6,842 million; September 30, 2017: $5,778 million) of trading securities. In addition, the Banking Group held $88,041 million (September 30, 2018: $83,051 million; September 30, 2017: $79,441 million) of net loans and advances to customers, of which $25,718 million (September 30, 2018: $22,938 million; September 30, 2017: $22,181 million) is due to mature within one year. A proportion of these maturing customer loans will be extended in the normal course of business.

The Banking Group's funding policies are designed to achieve diversified sources of funding by product, term, maturity concentration, investor type, investor location, jurisdiction and currency, on a cost effective basis.

The Banking Group's sources of funding include deposits and other borrowings which contain on demand and short term deposits, term deposits, and bank issued certificates of deposit. Of total liabilities as at September 30, 2019 of $101,179 million (September 30, 2018: $92,612 million; September 30, 2017: $88,374 million), funding from customer deposits and certificates of deposit amounted to $64,414 million (September 30, 2018: $61,570 million; September 30, 2017: $57,482 million) or 63.7% (September 30, 2018: 66.5%; September 30, 2017: 65.0%). Although a substantial portion of customer accounts are contractually repayable within one year, on demand, or on short notice, such customer deposit balances have provided a stable source of core long term funding for the Banking Group.

Deposits taken from banks and other financial institutions of $1,833 million as at September 30, 2019 (September 30, 2018: $1,944 million; September 30, 2017: $1,594 million) supplement the Banking Group's customer deposits. The Banking Group also accesses the domestic and international debt capital markets under its various funding programs. As at September 30, 2019, the Banking Group had on issue $23,069 million (September 30, 2018: $21,706 million; September 30, 2017: $21,981 million) of term debt securities (bonds, notes and subordinated debt) and $3,554 million (September 30, 2018: $1,867 million; September 30, 2017: $2,430 million) of commercial paper.

The net cash flow from operating activities in 2019 was an outflow of $379 million (2018: inflow of $1,676 million; 2017: outflow of $3,219 million). The movements in net cash flow from operating activities are primarily attributable to the timing of transactions. The Banking Group maintains a liquid asset portfolio and has the ability to access wholesale money markets and issue debt securities should the need arise. Overall liquidity is considered sufficient to meet current obligations to customers and debt holders.

The Banking Group's funding programs as at September 30, 2019 are summarized in the table below. In addition to these programs, from time to time the Banking Group may issue capital securities that are in compliance with the RBNZ's capital adequacy standards.

Active Funding Programs

	Consolidated (2019)			
Dollars in Millions	Program Size	Amount Outstanding NZD	Issuing Entity	Principal Market
U.S. Commercial Paper Program – short term debt securities	USD10,000	3,554	BNZ-IF[1]	Offshore U.S.-based
Global Commercial Paper Program – short term debt securities	USD10,000	-	BNZ-IF[1]	Offshore non U.S.-based
Debt Issuance Program (certificates of deposit) - short term debt securities	Unlimited	1,349	BNZ	Domestic
Global Medium Term Note Program	USD100,000	14,029	BNZ and BNZ-IF[1]	Offshore
BNZ Covered Bond Program	NZD7,000	4,382	BNZ and BNZ-IF[2]	Offshore and Domestic
Debt Issuance Program (medium term notes)	Unlimited	2,710	BNZ	Domestic

[1] Securities issued by BNZ-IF are guaranteed by BNZ.

[2] Covered bonds issued by BNZ and BNZ-IF are guaranteed as to the payments of all interest and principal by CBG Trustee Company Limited as trustee of the BNZ Covered Bond Trust. In addition, the payment of all amounts owing by BNZ-IF in respect of covered bonds issued by BNZ-IF is guaranteed by BNZ.

Liquidity and Funding *continued*

Internal residential mortgage-backed securities program

In May 2008, the RBNZ expanded the range of acceptable collateral that banks can pledge and borrow against as part of changes to its liquidity management arrangements designed to help to ensure adequate liquidity for New Zealand financial institutions in the event that global market disruption were to intensify. From July 31, 2008, acceptable collateral included residential mortgage-backed securities ("RMBS") that satisfy the RBNZ's criteria.

The BNZ RMBS Trust Series 2008-1 (the "RMBS Trust") provides an internal RMBS program. As at September 30, 2019, included within the Banking Group's loans and advances to customers were housing loans held by the RMBS Trust with a carrying amount of $6,478 million (September 30, 2018: $4,471 million; September 30, 2017: $4,471 million). These housing loans have not been derecognized by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. The RBNZ has not accepted any RMBS as collateral from the Banking Group as at September 30, 2019 and, as a result, the securities issued by the RMBS Trust remain unencumbered.

As at September 30, 2019, the Banking Group also held unencumbered RMBS of $6,500 million (September 30, 2018: $4,491 million) of which $6,240 million (September 30, 2018: $4,300 million) is available to be sold to the RBNZ under agreements to repurchase for liquidity purposes. The amount of $6,240 million is subject to a 19% reduction in value and a 4% limit on the Banking Group's total assets giving a net balance of $4,269 million (September 30, 2018: $3,483 million).

BNZ Covered Bond program

The BNZ Covered Bond Trust (the "Covered Bond Trust") holds certain BNZ housing loans and its trustee guarantees the payment of all interest and principal under the covered bonds issued by BNZ and BNZ-IF. The assets of the Covered Bond Trust are not available to the Bank unless and until all prior ranking creditors of the Covered Bond Trust have been satisfied. As at September 30, 2019, included within the Banking Group's loans and advances to customers were housing loans with a carrying amount of $4,686 million held by the Covered Bond Trust (September 30, 2018: $5,051 million; September 30, 2017: $6,045 million). These housing loans have not been derecognized by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership.

Capital Resources

Capital Adequacy

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

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

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

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

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

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

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

Capital management policies

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

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

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

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

Capital requirements, as detailed in the Banking Group's ICAAP document, are managed by the Bank's RRMC and ALCCO under delegated authority from the Board of Directors.

The tables included below and on the following pages detail the capital calculation, capital ratios and capital requirements as at September 30, 2019, September 30, 2018 and September 30, 2017. During the financial year ended September 30, 2019 the Banking Group complied with all RBNZ's capital requirements as set out in the Bank's Conditions of Registration, except as disclosed on page 87 of the Disclosure Statement for the year ended September 30, 2019.

Capital Resources *continued*

Capital Adequacy *continued*

Regulatory capital

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

	Consolidated		
Dollars in Millions	Unaudited 2019	Unaudited 2018	Unaudited 2017
Qualifying capital			
Common Equity Tier 1 capital			
Contributed equity - ordinary shares	4,056	3,456	2,351
Retained profits	3,778	3,885	4,538
Accumulated other comprehensive income and other disclosed reserves	96	35	49
Deductions from Common Equity Tier 1 capital:			
Goodwill and other intangible assets	293	352	277
Cash flow hedge reserve	96	35	49
Credit value adjustment on liabilities designated at fair value through profit or loss	(27)	(42)	(85)
Prepaid pension assets (net of deferred tax)	4	4	3
Deferred tax asset	197	196	191
Total expected loss less total eligible allowances for impairment	48	21	74
Credit enhancements	1	-	-
Total Common Equity Tier 1 capital	7,318	6,810	6,429
Additional Tier 1 capital			
Subordinated debt due to related entities	900	900	900
Total Additional Tier 1 capital	900	900	900
Total Tier 1 capital	8,218	7,710	7,329
Tier 2 capital			
Revaluation reserves	3	3	3
Subordinated debt due to related entities	500	500	181
Subordinated debt due to external investors	550	550	550
Total eligible impairment allowance in excess of expected loss	20	-	-
Total Tier 2 capital	1,073	1,053	734
Total Tier 1 and Tier 2 qualifying capital	9,291	8,763	8,063

Banking Group Basel III regulatory capital ratios

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

	Consolidated			
	Regulatory Minima 2019	Unaudited 2019	Unaudited 2018	Unaudited 2017
Common Equity Tier 1 capital ratio	4.50%	10.97%	10.56%	10.38%
Tier 1 capital ratio	6.00%	12.32%	11.95%	11.83%
Total qualifying capital ratio	8.00%	13.93%	13.59%	13.02%
Buffer ratio	2.50%	5.93%	5.59%	5.02%

Capital Resources *continued*

Capital Adequacy *continued*

Total regulatory capital requirements

	Consolidated								
Dollars in Millions	Total Exposure at Default Unaudited 2019	Risk-Weighted Exposure or Implied Weighted Exposure Unaudited 2019	Total Capital Require-ment[1] Unaudited 2019	Total Exposure at Default Unaudited 2018	Risk-Weighted Exposure or Implied Weighted Exposure Unaudited 2018	Total Capital Require-ment[1] Unaudited 2018	Total Exposure at Default Unaudited 2017	Risk-Weighted Exposure or Implied Weighted Exposure Unaudited 2017	Total Capital Require-ment[1,3] Unaudited 2017
Credit risk									
Exposures subject to the internal ratings based approach	**111,597**	**46,708**	**3,737**	107,137	45,592	3,647	101,060	44,166	3,533
Equity exposures	**3**	**12**	**1**	12	49	4	13	52	4
Specialized lending subject to the slotting approach	**8,804**	**8,150**	**652**	8,515	8,049	644	8,787	8,339	667
Exposures subject to the standardized approach	**2,400**	**940**	**75**	2,393	980	78	2,681	1,191	95
Credit value adjustment subject to BS2B	**N/A**	**2,030**	**162**	N/A	1,166	93	N/A	954	77
Agribusiness supervisory adjustment[2]	**N/A**	**1,048**	**84**	N/A	1,045	84	N/A	-	-
Total credit risk	**122,804**	**58,888**	**4,711**	118,057	56,881	4,550	112,541	54,702	4,376
Operational risk	**N/A**	**4,413**	**353**	N/A	4,375	350	N/A	4,375	350
Market risk	**N/A**	**3,417**	**273**	N/A	3,236	259	N/A	2,864	229
Total	**122,804**	**66,718**	**5,337**	118,057	64,492	5,159	112,541	61,941	4,955

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

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

[3] Comparative data for the Banking Group's 2017 capital ratios were restated due to a data error in the Banking Group's unutilized credit limit.

Additional information on the capital adequacy of the Banking Group is detailed in the capital adequacy note of the Disclosure Statements for the periods specified.

Off-Balance Sheet Arrangements, Contingent Liabilities and Credit Related Commitments

Off-balance sheet arrangements are considered to be commitments that have or are reasonably likely to have a current or future material effect on the Banking Group’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefits is not probable or cannot be reliably measured. Where some loss is probable, provisions have been made. The notional amount represents the maximum potential amount that could be lost if a counterparty fails to meet its financial obligations. Contingent liabilities are not recognized in the balance sheet, but are disclosed unless the likelihood of payment is remote.

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

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

Overall, the number and scale of regulatory investigations, reviews and litigation involving banking institutions has increased significantly over the 2019 and 2018 financial years. The Banking Group has received information requests from its regulators as part of both industry and bank-specific reviews being undertaken, and the Banking Group has also initiated contact with its regulators on compliance-related matters. The scope of reviews, inquiries and investigations can be wide-ranging and result in customer remediation programs.

There are contingent liabilities in respect of all the above matters. Where appropriate, provisions have been made. The aggregate potential liability of the Banking Group in relation to these matters cannot be accurately assessed.

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

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

Capital Resources *continued*

Off-Balance Sheet Arrangements, Contingent Liabilities and Credit Related Commitments *continued*

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

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

	Consolidated		
	Notional Amount	Notional Amount	Notional Amount
Dollars in Millions	2019	2018	2017
Contingent liabilities			
Bank guarantees	66	72	79
Standby letters of credit	259	301	292
Documentary letters of credit	75	120	105
Performance related contingencies	653	630	635
Total contingent liabilities	1,053	1,123	1,111
Credit related commitments			
Revocable commitments to extend credit	9,363	9,604	8,395
Irrevocable commitments to extend credit	11,732	12,008	11,844
Total credit related commitments	21,095	21,612	20,239
Total contingent liabilities and credit related commitments	22,148	22,735	21,350

Operating lease commitments

	Consolidated		
Dollars in Millions	2019	2018	2017
Operating lease commitments	228	230	237

Capital expenditure commitments that have been entered into but not provided for are not disclosed in this document as the amounts represented by such commitments are not material to the Banking Group.

Contractual Obligations by Maturity

The table below sets out the amounts and maturities of the Banking Group's contractual obligations for bonds, notes and subordinated debt, and operating lease commitments. It excludes deposits and other liabilities taken in the normal course of banking business and short term liabilities.

	Consolidated (2019)				
Dollars in Millions	Up to 1 Year	Over 1 Year and up to 3 Years	Over 3 Years and up to 5 Years	Over 5 Years	Total
Bonds, notes and subordinated debt[1]	3,956	7,672	9,570	1,871	23,069
Operating lease commitments	57	83	61	27	228
Total contractual obligations	4,013	7,755	9,631	1,898	23,297

[1] For the purpose of this disclosure, the amounts show the contractual maturity distribution of the carrying value of the Banking Group's bonds, notes and subordinated debt.

Derivatives and Market Exposures

All derivatives are recognized in the balance sheet at fair value on the trade date and are classified as trading except where they are used as part of an effective hedge relationship. The carrying value of a derivative is remeasured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative.

The method of recognizing the fair value gain or loss on a derivative depends on whether the derivative is used as a hedging instrument and, if so, the nature of the item being hedged. The Banking Group designates certain derivatives entered into for risk management purposes as either hedges of highly probable future cash flows attributable to a recognized asset or liability or a forecast transaction (cash flow hedge) or hedges of the fair value of recognized assets and liabilities (fair value hedge). Hedge accounting is generally used for derivatives designated in this way, provided certain criteria are met.

Derivatives used for risk management purposes which, for various reasons, do not meet the qualifying criteria for hedge accounting, are included in trading derivatives. Any derivative that is de-designated as a hedging derivative will be accounted for as trading from the time that it is de-designated, with all subsequent movements in fair value recognized in the income statement.

The Banking Group elected to apply NZ IFRS 9 to account for designated hedge relationships, other than portfolio fair value hedges, from April 1, 2018. The Banking Group continues to account for designated portfolio fair value hedge relationships under NZ IAS 39 as dynamic portfolio risk management is out of scope under NZ IFRS 9.

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

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

For details of trading and hedging derivative financial instruments, refer to "Derivative financial instruments" on page 30 herein and Note 14 Derivative Financial Instruments of the Disclosure Statement for the year ended September 30, 2019.

Market Exposures

The Banking Group offers a range of financial products, including derivatives, in connection with which the Bank has deemed it has the expertise in the relevant market and infrastructure to support management processes. Executing this strategy may result in market risk for the Banking Group, which is the risk of financial loss from unfavorable movements in market variables such as interest or foreign exchange rates. The Banking Group's activities involve the use of financial instruments to mitigate market risk or selectively position for favorable movements.

Financial instruments designated as traded market risk include those which:

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

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

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

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

All trading activities are subject to the disciplines prescribed in the NAB Group Market Risk Policy, which is approved by the NAB Board. This includes the use of VaR methodology.

Derivatives and Market Exposures

Market Exposures *continued*

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

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

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

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

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

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

	Consolidated					
	As At			Average Value During Year		
Dollars in Millions	**2019**	2018	2017	**2019**	2018	2017
VaR at a 99% confidence level						
Foreign exchange risk	**1.46**	0.07	0.47	**0.72**	0.32	0.48
Interest rate risk	**1.13**	0.99	2.59	**1.52**	1.95	2.25
Volatility risk	**0.01**	-	0.01	**0.01**	0.01	0.03
Credit spread risk	**0.32**	0.23	0.23	**0.24**	0.25	0.29
Diversification benefit	**(1.31)**	(0.36)	(0.78)	**(0.85)**	(0.54)	(0.69)
Total VaR for physical and derivative positions	**1.61**	0.93	2.52	**1.64**	1.99	2.36

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

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

Derivatives and Market Exposures

Derivative financial instruments

Dollars in Millions	Fair Value Assets 2019	Fair Value Liabilities 2019	Fair Value Assets 2018	Fair Value Liabilities 2018	Fair Value Assets 2017	Fair Value Liabilities 2017
Trading derivatives (including economic hedges)	7,544	6,106	4,286	3,053	3,762	3,217
Hedging derivatives	72	-	50	-	43	2
Total derivative financial instruments	7,616	6,106	4,336	3,053	3,805	3,219

Trading derivatives

Dollars in Millions	Fair Value Assets 2019	Fair Value Liabilities 2019	Fair Value Assets 2018	Fair Value Liabilities 2018	Fair Value Assets 2017	Fair Value Liabilities 2017
Foreign exchange rate-related contracts						
Spot and forward contracts to purchase foreign exchange	1,659	1,564	838	716	399	461
Cross currency swaps	1,623	1,698	983	675	753	903
Options	61	61	47	47	62	62
	3,343	3,323	1,868	1,438	1,214	1,426
Interest rate-related contracts						
Swaps	4,181	2,764	2,382	1,579	2,533	1,776
	4,181	2,764	2,382	1,579	2,533	1,776
Other market-related contracts						
Commodity derivatives	17	16	31	31	10	10
Credit derivatives	3	3	5	5	5	5
	20	19	36	36	15	15
Total trading derivatives (including economic hedges)	7,544	6,106	4,286	3,053	3,762	3,217

Hedging derivatives

Dollars in Millions	Hedging instrument	Risk	Notional Amount 2019	Fair Value Amount 2019	Notional Amount 2018	Fair Value Amount 2018	Notional Amount 2017	Fair Value Amount 2017
Derivative assets								
Cash flow hedges	Interest rate swaps	Interest	8,133	72	7,571	50	6,530	43
Cash flow hedges	Futures	Interest	1,587	-	4,699	-	7,645	-
Fair value hedges	Interest rate swaps	Interest	230	-	180	-	1,352	-
			9,950	72	12,450	50	15,527	43
Derivative liabilities								
Cash flow hedges	Interest rate swaps	Interest	5,515	-	5,022	-	4,379	1
Cash flow hedges	Futures	Interest	800	-	4,250	-	5,995	-
Fair value hedges	Interest rate swaps	Interest	14,963	-	12,688	-	13,882	1
			21,278	-	21,960	-	24,256	2

Industry and Regulation

Supervisory Role of the RBNZ

The Reserve Bank Act requires the RBNZ to exercise its powers of registration of banks and prudential supervision of registered banks for the purposes of:

- promoting the maintenance of a sound and efficient financial system; or
- avoiding significant damage to the financial system that could result from the failure of a registered bank.

The RBNZ's policy on the registration of banks aims to ensure that only financial institutions of appropriate standing and repute are able to become registered banks. Subject to this requirement, the RBNZ has stated that in order to encourage competition in the banking system it intends to keep to a minimum any impediments to the entry of new registered banks.

The RBNZ's supervisory functions are aimed at encouraging the soundness and efficiency of the financial system as a whole and are not aimed at preventing individual bank failures or at protecting creditors. The RBNZ encourages this by drawing on and enhancing disciplines that are naturally present in the market.

As a consequence, the RBNZ places considerable emphasis on a requirement that the banks disclose, on a six-monthly basis, information about financial performance and risk positions, and on a requirement that directors regularly attest to certain key matters. These measures are intended to strengthen market disciplines and to ensure that responsibility for the prudent management of banks lies with those who the RBNZ considers are best placed to exercise that responsibility – the directors and management.

The main elements of the RBNZ's supervisory role include:

- requiring all banks to comply with certain minimum prudential requirements, which are applied through their conditions of registration. These include constraints on connected exposures, minimum capital adequacy requirements and minimum standards for liquidity risk management;
- monitoring each registered bank's financial condition and compliance with its conditions of registration, principally on the basis of published semi-annual disclosure statements. This monitoring is intended to ensure that the RBNZ maintains familiarity with the financial condition of each bank and the banking system as a whole, and maintains a state of preparedness to invoke crisis management powers should this be necessary;
- engaging with the senior management and independent directors of registered banks;
- using crisis management powers available to it under the Reserve Bank Act to intervene where a bank's distress or failure threatens the soundness of the financial system;
- assessing whether a bank is carrying on business prudently;
- issuing guidelines to counter money laundering and the financing of terrorism;
- issuing guidelines on banks' internal capital adequacy process and liquidity policy;
- issuing guidelines on corporate governance; and
- maintaining close working relationships with parent bank supervisors (such as APRA in Australia) on bank-specific issues, policy issues and general matters relating to the condition of the financial system in New Zealand and in the countries where parent banks are domiciled.

The disclosure statements that are required to be issued semi-annually by registered banks contain comprehensive corporate details and full financial statements at the full year, and unaudited interim financial statements at the half year. They are subject to a full external audit at the end of each financial year and a limited scope review at the end of each financial half year. The disclosure statements must be signed by each bank director or by each director's agent authorized in writing to do so. Each director must also make certain attestations. A bank and its directors may incur criminal and civil penalties if the bank's disclosure statement contains information that is held to be false or misleading. RBNZ has replaced the requirement for locally incorporated banks to prepare off-quarter disclosure statements with a new Dashboard requirement. The Dashboard involves publication on the RBNZ's website of key information on locally incorporated banks, in order to facilitate comparisons across banks and to make this information more accessible.

The RBNZ also requires all registered banks to obtain and maintain a credit rating from an approved organization and publish that rating in their quarterly Dashboard and semi-annual disclosure statements.

In addition, the RBNZ has wide reaching powers to obtain further information, data and forecasts in connection with its supervisory functions, and to require that information, data, and forecasts be audited.

The RBNZ also possesses a number of crisis management powers. Those powers include recommending that a bank's registration be cancelled, investigating the affairs of a registered bank, requiring that a registered bank consult with the RBNZ, giving directions to a registered bank which includes removing, replacing or appointing a director of a registered bank or recommending that a registered bank be subject to statutory management.

If a registered bank is declared to be subject to statutory management, no person may, among other things:

- commence or continue any action or other proceedings including proceedings by way of counterclaim against that bank;
- issue any execution, attach any debt, or otherwise enforce or seek to enforce any judgment or order obtained in respect of that bank;
- take any steps to put that bank into liquidation; or
- exercise any right of set off against that bank.

As part of the RBNZ's supervisory powers, a person must obtain the written consent of the RBNZ before giving effect to a transaction resulting in that person acquiring or increasing a "significant influence" over a registered bank. "Significant influence" means the ability to appoint 25% or more of the board of directors of a registered bank or a qualifying interest (for example, legal or beneficial ownership) in 10% or more of the bank's voting securities.

In assessing applications for consent to acquire a significant influence over a registered bank, the RBNZ has stated that it will have regard to the same matters as are relevant in assessing an application for registration as a registered bank. In giving its consent, the RBNZ may impose such terms and conditions as it deems fit.

For the Banking Group's conditions of registration, refer to the Disclosure Statement for the year ended September 30, 2019. Subsequent changes to the Banking Group's conditions of registration during a reporting period are set out in the Disclosure Statement for that period.

Industry and Regulation

Overview of the New Zealand Financial System

The RBNZ publishes a semi-annual Financial Stability Report, in which it assesses and reports on the soundness and efficiency of the New Zealand financial system. The following section is an excerpt from the most recent RBNZ Financial Stability Report ("RBNZ Report") that was released on May 29, 2019. The information in this section has been accurately reproduced from the summaries introducing a number of sections in the RBNZ Report and as far as the Banking Group is aware and is able to ascertain, no facts have been omitted that would render the reproduced information inaccurate or misleading. For more information, please see the full RBNZ Report, which is available from the RBNZ's website at http://www.rbnz.govt.nz/financial-stability/financial-stability-report.

"Chapter 1
Financial stability risk and policy assessment

New Zealand's financial system remains resilient to a broad range of economic risks. It remains vulnerable to severe, unlikely, risks that could cause many highly indebted New Zealand households and dairy farms to default. It is also vulnerable to international risks that could cause a major global economic recession. These vulnerabilities remain elevated but have been largely steady over the past six months. More work is needed to make the financial system more efficient and resilient to more severe risks. It is imperative to improve the resilience of New Zealand's financial system, while conditions are conducive.

A material portion of New Zealand households and dairy farms have high debt levels that they would struggle to service if their incomes fell or costs rose (figure 1.1). Banks would face large losses if many borrowers defaulted on their loans, particularly in an environment of sharply falling house and farm prices (see chapter 2). This scenario is unlikely but it remains possible, if there were a large shock to New Zealand's economy or financial system."

"Chapter 2
Domestic vulnerabilities

New Zealand's financial system has two main domestic vulnerabilities: household sector indebtedness and agriculture sector indebtedness. These vulnerabilities remain largely unchanged in the past six months.

The domestic economy is important for New Zealand's financial system because it affects loan losses, asset values and profitability. The pace of annual economic growth has moderated over the past year, from 3.1 percent at the start of 2018 to 2.3 percent at end 2018.

Slower growth and employment momentum is expected over the first half of 2019, due to emerging domestic and international headwinds. Domestic headwinds include slowing net migration, low house price inflation and low business confidence. International headwinds include falling export demand growth, as global economic growth remains below levels seen in recent years. The Reserve Bank reduced the Official Cash Rate in May in response to New Zealand's slower growth momentum. Extra monetary policy stimulus and elevated terms of trade are expected to help support a recovery in growth and employment from late 2019."

"Chapter 3
International vulnerabilities

As a small open economy, New Zealand is particularly vulnerable to the impact of unexpected global economic events. New Zealand relies on export income and international funding markets to service its external debt of around 95 percent of GDP. New Zealand insurers also rely on global reinsurance markets to help insure risks. The Reserve Bank monitors the key vulnerabilities in the global economy and financial markets, and assesses how they could spill over to New Zealand.

Over the past six months, conditions in the global economy and financial markets have weakened. Global economic growth has slowed to around its 10-year average, against a backdrop of continued uncertainty about the outlook for world trade. The impact of a sustained global slowdown would likely be amplified by high debt levels and asset prices in many economies. Policymakers' ability to respond to a global slowdown may be hampered by low interest rates and high government debt levels in some advanced economies."

"Chapter 4
Financial system assessment

New Zealand's financial system underpins the country's economy. It facilitates borrowing and saving, allows people to diversify and transfer risks, and helps people exchange goods and services by providing convenient means of payment.

Banks dominate the domestic financial system (figure 4.1). Banking products are widely available across New Zealand, and almost all adult have bank accounts. However, the banking system itself is concentrated, and just four banks account for 86 percent of bank lending. The non-bank lending sector is small compared to the banking sector, and only competes with banks in some regions and products. New Zealand's capital markets are small relative to the banking sector and to capital markets in other advanced economies. This limits funding and investment opportunities in New Zealand.

New Zealand has a large general insurance sector and good levels of general insurance penetration by international standards. However, the insurance sector is concentrated on a few large insurers, particularly for some products such as health insurance. And there are emerging challenges to the affordability of some general insurance products (see the insurance section)."

"Chapter 5
Regulatory developments and initiatives

The Reserve Bank undertakes a wide range of reviews, consultations and initiatives to ensure it best meets its objective of promoting the maintenance of a sound and efficient financial system. This helps ensure that the Reserve Bank's policies and practices are up to date and respond to changes in the financial system, legal system and broader regulatory landscape in New Zealand and abroad."

As of the date of this document, the RBNZ's website states that the next RBNZ Financial Stability Report is expected to be released on November 27, 2019.

Our Business

Overview

Bank of New Zealand is a registered bank incorporated in New Zealand on July 29, 1861 and its address for service of process is Level 4, 80 Queen Street, Auckland 1010, New Zealand.

The Banking Group provides a broad range of banking and financial products and services to retail, business, agribusiness, corporate and institutional clients. The New Zealand Government became a shareholder in BNZ in 1904, BNZ was nationalized in 1945 and BNZ returned to a private shareholding in 1987. In 1992, BNZ became a subsidiary of the NAB Group when the NAB Group purchased the ordinary shares and convertible preference shares of BNZ.

The Banking Group's business is organized into three major reportable operating segments: Partnership Banking; Private, Wealth and Insurance; and Corporate and Institutional Banking. Partnership Banking provides financial products and services to retail, business and corporate customers. Private, Wealth and Insurance provides private banking, investments products and services to retail customers, and for management reporting purposes, includes insurance activities carried out by a controlled entity of NAB that is not part of the Banking Group. Corporate and Institutional Banking provides financial products and services to corporate agribusiness and institutional customers. Prior to April 1, 2019 the Banking Group was organized into two major operating and reportable segments: Consumer and Wealth and BNZ Partners.

During the current and preceding financial year, there have been no public takeover offers by third parties in respect of the Banking Group's shares or by the Banking Group in respect of other companies' shares, and there have been no material contracts outside of the ordinary course of business.

Geographical Revenue Information

The Banking Group has operations primarily in New Zealand. BNZ and BNZ-IF issue debt securities outside of the New Zealand domestic market as part of BNZ's offshore funding program. Geographical revenue information is based on the location of the office in which the transactions were recorded. Geographical revenue information is available in the table below.

	Consolidated		
Dollars in Millions	**2019**	2018	2017
Revenue from external customers			
New Zealand	**2,656**	2,556	2,315
Outside of New Zealand	**-**	-	-
Total revenue	**2,656**	2,556	2,315

Organizational Structure

BNZ is the holding company for the Banking Group, as well as the main operating company.

BNZ is wholly owned by NAGNZ, which is the immediate parent of BNZ. The ultimate parent bank of BNZ is NAB.

Number of Employees

	Consolidated				
	As at			Change	
	2019	2018	2017	2019 vs 2018	2018 vs 2017
Number of full-time equivalent employees	**4,503**	4,703	4,787	(200)	(84)

The number of full-time equivalent employees within the Banking Group has decreased by 200 or 4.3% from 2018 to 2019, primarily attributable to the continuation of the alignment of roles to the Bank's strategic initiatives.

BNZ and the New Zealand trade union which represents New Zealand finance industry workers ("FIRST Union") have concluded bargaining and agreed a new collective agreement that applies to FIRST Union members for the next two years (until October 31, 2021). There is presently no significant employment dispute between BNZ and any of its union-member employees or between BNZ and FIRST Union.

Related Entity Transactions

During the financial year ended September 30, 2019, there have been dealings between the Bank and its related entities (including its ultimate parent, NAB, other members of the NAB Group and controlled entities of the Bank) as well as other related parties (including key management personnel, their close family members and their controlled entities).

BNZ provides a range of services to related entities including the provision of banking facilities. These transactions are subject to commercial terms and conditions. BNZ provides some accounting administration and banking services to controlled entities for which fees may be charged.

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

The Banking Group provides banking and other administrative services to its related entities on arm's length terms and conditions where such provision of services does not involve more than the normal risk of collectability or present other unfavorable features.

No provisions have been recognized in respect of loans provided to related entities. No debts with any of the related entities were written off or forgiven during the year ended September 30, 2019 (year ended September 30, 2018: nil; year ended September 30, 2017: nil).

Details of other transactions with related entities are outlined in Note 24 Related Entity Transactions of the Disclosure Statement.

Related Entity Transactions *continued*

Dollars in Millions	Consolidated 2019	2018	2017
Total balances with related entities			
Amounts due from related entities			
Loans outstanding to ultimate parent	578	1,222	640
Loans outstanding to controlled entities of ultimate parent	37	31	37
Total amounts due from related entities	615	1,253	677
Derivative financial assets with related entities	2,756	1,496	1,294
Amounts due to related entities			
Deposits from ultimate parent	520	544	216
Deposits from controlled entities of ultimate parent	318	369	303
Total amounts due to related entities	838	913	519
Derivative financial liabilities with related entities	2,359	1,210	1,393
Subordinated debt due to related entities	1,400	1,400	1,280

Management

BNZ Board

Composition of BNZ Board

As at September 30, 2019, the members of the BNZ Board were as follows:

Name	Position
Douglas Alexander McKay	Non-Executive Director, Chairman
Angela Mentis	Managing Director and Chief Executive Officer
Mai Chen	Independent Non-Executive Director
Prudence Mary Flacks	Independent Non-Executive Director
Bruce Ronald Hassall	Independent Non-Executive Director
Louis Arthur Hawke	Independent Non-Executive Director
Kevin John Kenrick	Independent Non-Executive Director
Gary Andrew Lennon	Non-Executive Director

As at September 30, 2019, except as detailed in the paragraph below, no conflicts of interest and no potential conflicts of interest existed between any duties owed to BNZ by the members of the BNZ Board listed above and their private interests or duties outside of the Banking Group.

Mr. McKay is a director of IAG New Zealand Limited and IAG (NZ) Holdings Limited. As at September 30, 2019, BNZ contracted with IAG New Zealand Limited for the provision of insurance products and services. The BNZ Board receives regular management reports, both directly and through BRC, which may contain sensitive information.

BNZ has a process for the management of any conflicts of interest that may arise. Further details are provided under "BNZ Constitution" on page 38.

The BNZ Board has adopted a Board Charter which sets out the BNZ Board's purpose, powers and responsibilities.

Douglas McKay, ONZM
B.A. (Auckland), A.M.P. (Harvard Business School)
Douglas McKay is the Chairman of the BNZ Board and was appointed as a non-executive director of BNZ in March 2013. Mr. McKay was appointed as a non-executive director of NAB in February 2016.

Mr. McKay brings considerable commercial experience to the BNZ Board. His previous roles include senior positions with Auckland Council, Carter Holt Harvey Limited, Goodman Fielder New Zealand Limited, Independent Liquor (NZ) Limited, Lion Nathan Limited, Procter & Gamble and Sealord Group Limited.

Mr. McKay is a director of Fletcher Building Industries Limited, Fletcher Building Limited, Genesis Energy Limited, IAG New Zealand Limited and IAG (NZ) Holdings Limited. Mr. McKay is the Chairman of the Eden Park Trust Board.

Angela Mentis
B.Bus., GDip Applied Finance, GAICD
Angela Mentis was appointed Managing Director and CEO of BNZ in January 2018.

Ms. Mentis has extensive business, retail and institutional banking and wealth management experience spanning more than 30 years. She was appointed to the role of Chief Customer Officer – Business and Private Banking at NAB in August 2016. Prior to this, she held the role of Group Executive, Business Banking at NAB from August 2014. Before joining NAB, Ms. Mentis held senior roles at BT Financial Group and Westpac Institutional Bank.

Ms. Mentis is a director of Banking Ombudsman Scheme Limited.

Mai Chen
LL.B. (Hons.) (Otago), LL.M. (Harvard), FNZIM
Mai Chen was appointed as an independent non-executive director of BNZ in April 2015.

Ms. Chen is a barrister and solicitor with significant commercial and business experience, and is an Adjunct Professor at the University of Auckland Law School. She specializes in public, regulatory and employment law and judicial review litigation, and has served on the Securities Commission of New Zealand, which has been superseded by the Financial Markets Authority (New Zealand). Ms. Chen was previously on the Advisory Board of AMP Life Limited (NZ).

Ms. Chen is a Managing Partner at Chen Palmer New Zealand Public Law Specialists Limited and a director of Chen Palmer New Zealand Public Law Specialists Limited and CPP Limited. She is also the Chair of ASIANZ CEO Limited, Superdiverse Women Limited, Superdiversity Centre for Law, Policy and Business Limited and the Superdiversity Institute for Law, Policy and Business.

Prudence Flacks
LL.B., LL.M.
Prudence Flacks was appointed as an independent non-executive director of BNZ in October 2009.

Ms. Flacks is a professional director with experience across a range of industries. She was formerly a commercial lawyer and a partner in the national law firm Russell McVeagh for 20 years. Her expertise included corporate and regulatory matters, corporate finance, capital markets and business restructuring.

Ms. Flacks is a director of Chorus Limited and the Chair of Queenstown Airport Corporation Limited and Mercury NZ Limited.

Management

BNZ Board *continued*

Bruce Hassall
B.Com., FCA
Bruce Hassall was appointed as an independent non-executive director of BNZ in December 2015.

Mr. Hassall is a chartered accountant and was previously Senior Partner and CEO of PricewaterhouseCoopers New Zealand. Mr. Hassall has considerable commercial and strategic experience, together with technical audit, finance and governance knowledge. His areas of expertise include financial reporting and capital raising, and he has extensive industry knowledge across a wide range of sectors.

Mr. Hassall is a director of Fonterra Co-Operative Group Limited. Mr. Hassall is the Chair of Fletcher Building Industries Limited, Fletcher Building Limited, The Farmers' Trading Company Limited and Prolife Foods Limited.

Louis Hawke
BEc (Hons), MBA
Louis Hawke was appointed as an independent non-executive director of BNZ in February 2017. He is the Chair of BNZ Insurance Services Limited and BNZ Life Insurance Limited.

Mr. Hawke has significant experience in consulting, private equity and financial services. Mr. Hawke has held managing director roles in retail banking at ANZ and general manager roles at Westpac and Advance Bank in retail and commercial banking. Prior to financial services, Mr. Hawke was with McKinsey & Company, where he specialized in strategic evaluations and takeovers, and was an economist with the Australian Government Department of the Prime Minister and Cabinet, providing advice on economic issues and policy.

Kevin Kenrick
BMS
Kevin Kenrick was appointed as an independent non-executive director of BNZ in July 2016.

Mr. Kenrick is currently CEO of Television New Zealand Limited. Mr. Kenrick has led the state broadcaster through a significant period of digital evolution, managing its transition from a free-to-air offering to a multi-platform offering including TVNZ OnDemand. Mr. Kenrick held the role of CEO of House of Travel from 2008 to 2011.

Mr. Kenrick is a director of Freeview Television Limited, NZOOM Limited, TVNZ International Limited and TVNZ Investments Limited. Mr. Kenrick is the Chair of Good George Brewing Advisory Board.

Gary Lennon
BEc (Hons) Sydney, FCA
Gary Lennon was appointed as a non-executive director of BNZ in May 2019.

Mr. Lennon has extensive banking and finance experience and was appointed to the role of NAB Group Chief Financial Officer in March 2016. He previously held the role of Executive General Manager Finance, leading the NAB Group's Finance function globally. Prior to this role, he was the Chief Financial Officer, Wholesale Banking, at NAB.

Before joining NAB in 2008, Mr. Lennon held a number of senior finance executive roles at Deutsche Bank in Australia, Japan and Singapore and KPMG in Sydney and London.

Mr. Lennon is a director of Imega Pty Limited and the Stronger Smarter Institute, an organization committed to improving the educational outcomes for Indigenous Australians.

Dates of appointment/reappointment of BNZ's directors as at September 30, 2019

Director	Date of Appointment	Last Date of Reappointment	Next Date of Reappointment
D A McKay	March 5, 2013	March 5, 2019	March 5, 2022
A Mentis	December 19, 2016	N/A	N/A
M Chen	April 21, 2015	April 21, 2018	April 21, 2021
P M Flacks	October 19, 2009	October 19, 2019	October 19, 2020
B R Hassall	December 21, 2015	December 21, 2018	December 21, 2021
L A Hawke	February 1, 2017	N/A	February 1, 2020
K J Kenrick	July 1, 2016	July 1, 2019	July 1, 2022
G A Lennon	May 1, 2019	N/A	N/A

Remuneration of BNZ directors
BNZ directors were paid aggregate directors' fees of $1,193,083, $1,191,167 and $1,178,685 for the years ended September 30, 2019, September 30, 2018 and September 30, 2017, respectively. Fees are set by NAB and BNZ directors have no voting power on their own compensation levels.

Directors' service contracts
BNZ has no service contracts in place providing for benefits for directors upon termination of employment.

Management

BNZ Executive Team

Composition of BNZ Executive Team ("BNZET")

As at September 30, 2019, the members of the BNZET were as follows:

Name	Position
Angela Mentis	Managing Director and Chief Executive Officer
Robert Reid Aitken	Executive General Manager, Transformation & Strategy
Paul Alexander Carter	Chief Customer Officer, Partnership Banking
Katherine Fiona Daly	Chief People Officer
Penelope Jane Ford	Chief Customer Officer, Corporate & Institutional
Russell Denis Jones	Executive General Manager, Technology & Operations
Peter Shane MacGillivray	Chief Financial Officer
Samuel John Perkins	Chief Risk Officer
Dean Campbell Schmidt	Executive General Manager, Corporate Affairs
Howard William Silby[1]	Chief Operating Officer
Christine Yates	Chief Customer Officer, Private, Wealth & Insurance

[1]On November 20, 2019, the Bank announced the proposed appointment of Mr. Daniel Huggins as Executive General Manager, Customer, Products & Services. Mr. Huggins replaces Mr. Howard Silby, Chief Operating Officer, as a member of the BNZET. These changes to the BNZET are effective March 2020 with Mr. Huggins' appointment being subject to RBNZ non-objection.

Diversity

As at September 30, 2019, the proportions of female directors on the BNZ Board and female members of the BNZET were 38% and 36%, respectively (September 30, 2018: 38% and 30%).

The Bank's diversity strategy and agenda is owned by the CEO and the BNZET. The Bank also has a Diversity and Inclusion Council which informs the diversity agenda while owning, advocating and influencing performance at the business unit level.

Board Committees

To assist in the execution of its responsibilities, the BNZ Board has established committees comprising NZRAC, BRC, the Board Due Diligence Committee and the People and Remuneration Committee, each with a Charter, to assist and support the BNZ Board in the conduct of its duties and obligations.

New Zealand Regional Audit Committee

NZRAC comprises three independent non-executive directors of BNZ. NZRAC assists the BNZ Board in fulfilling certain of its statutory, fiduciary and regulatory responsibilities and to provide an objective, non-executive review of the effectiveness of BNZ's financial reporting framework. NZRAC is responsible for the oversight and ensuring the integrity of:

- the accounting and financial statements, financial controls, financial and statutory reporting processes of BNZ, its subsidiaries, NAB and the National Wealth Management International Holdings Limited ("NWMIHL") group entities operating in New Zealand and other entities substantially associated with the activities of BNZ or domiciled in New Zealand (except all "JBWere" operated companies in New Zealand, at present specifically being JBWere (NZ) Pty Limited, JBWere (NZ) Holdings Limited and JBWere (NZ) Nominees Limited) (the "NZRAC Companies");
- the NZRAC Companies' external audit processes (including the appointment, evaluation and management and removal of the NZRAC Companies' external auditor(s));
- the NZRAC Companies' internal audit standards and processes including appointment and removal of the General Manager for Internal Audit;
- compliance with applicable accounting standards and policies and statutory and regulatory accounting requirements; to give a true and fair view of the financial position and performance of the NZRAC Companies; and
- tax risk and tax governance arrangements.

As at September 30, 2019 the members of NZRAC were Bruce Hassall (Chair), Mai Chen and Louis Hawke.

Board Risk Committee

As at September 30, 2019, BRC comprises all directors of BNZ. BRC assists the BNZ Board in fulfilling its statutory, fiduciary and regulatory responsibilities.

BRC is responsible for:

- oversight of the risk profile and risk management of BNZ, its subsidiaries and certain NAB and NWMIHL group entities operating in New Zealand (together, the "BRC Companies") within the context of the BNZ Board determined risk appetite;
- making recommendations to the BNZ Board (and where applicable to the BRC Companies) concerning current and future risk appetite, risk management strategy and particular risks or risk management practices;
- reviewing management's plans to mitigate material risks faced by the BRC Companies;
- oversight of the implementation and operation of the risk management framework and internal compliance and control frameworks throughout the BRC Companies including reviewing the risk management framework at least annually to confirm that it continues to be sound;
- oversight of stress testing of risk profiles including both scenario analysis and sensitivity analysis;
- promotion of a risk based culture throughout the BRC Companies which appropriately balances risk and reward for risk taken and oversight of the establishment by management of policies and procedures to embed this culture;
- reviewing assurances which will enable the BNZ Board and BRC to support the NAB Board and NAB Board Risk Committee to make a declaration to APRA on risk management;
- ensuring that the Chief Risk Officer has unfettered access to BRC via the BRC Secretary or Chair of BRC; and
- referring any matters of significant importance to the BNZ Board for its consideration and attention.

As at September 30, 2019, the members of BRC were Prudence Flacks (Chair), Mai Chen, Bruce Hassall, Louis Hawke, Kevin Kenrick, Douglas McKay, Angela Mentis and Gary Lennon.

Board Committees *continued*

Board Due Diligence Committee

The Board Due Diligence Committee was established on April 28, 2016 and comprises three independent non-executive directors. It assists the BNZ Board in fulfilling its statutory, fiduciary and regulatory responsibilities.

The Board Due Diligence Committee is responsible for ensuring due diligence is undertaken on disclosure documents in accordance with BNZ Board approved procedures.

As at September 30, 2019, Prudence Flacks was the Chair of the Board Due Diligence Committee, with members appointed from time to time by the Chairman of the BNZ Board.

People and Remuneration Committee

The People and Remuneration Committee comprises two independent non-executive directors and one non-executive director and it assists the BNZ Board in fulfilling its statutory, fiduciary and regulatory responsibilities.

The People and Remuneration Committee is responsible for reviewing, assessing and recommending to the BNZ Board, where necessary, staffing and remuneration policies and practices that meet the needs of BNZ, the expectations and requirements of regulators, and that enhance customer outcomes.

The People and Remuneration Committee is also responsible for monitoring, reviewing and recommending to the BNZ Board on a regular basis the following matters:

- culture and diversity;
- health and safety policies and principles; and
- the principles and framework required for measuring the conduct and behavioral requirements.

As at September 30, 2019, the members of the People and Remuneration Committee were Mai Chen (Chair), Kevin Kenrick and Douglas McKay.

Board Practices

As at September 30, 2019, the BNZ Board consists of eight directors, five of whom are independent non-executive directors, two of whom are non-executive directors and one of whom is an executive director of BNZ. The BNZ Board's composition is reviewed when a vacancy arises or if it is considered that the BNZ Board would benefit from the services of a new director, given the existing mix of skills and experience of the BNZ Board.

Under the conditions of registration imposed by the RBNZ, no appointment of any director, the Chair of the BNZ Board, the CEO, or executive who reports to, or is accountable directly to, the CEO, shall be made unless a copy of the curriculum vitae of the proposed appointee has been provided to the RBNZ and the RBNZ has advised that it has no objection to the appointment. The conditions of registration require that at least half the directors of the BNZ Board be independent and that the Chair is not an employee of BNZ.

BNZ Constitution

BNZ's constitution is publicly available online at https://companies-register.companiesoffice.govt.nz. Under BNZ's constitution, the BNZ Board holds all necessary powers for the management of the business and the operation of BNZ. There are no restrictions in BNZ's constitution on BNZ borrowing or providing a guarantee.

The BNZ Board has the power to issue shares in different classes and on different terms and conditions. Under the constitution, the BNZ Board is expressly authorized, subject to any special rights conferred on the holders of any shares or class of shares, to allot or otherwise dispose of shares with such preferred, deferred or other rights and subject to such restrictions on dividends, voting, return of capital, payment of calls or otherwise to such persons, on such terms and for such consideration as it thinks fit. However, before allotting or disposing of any shares to any person who is not an existing holder of any shares, the directors of BNZ must first offer the shares to NAB and if NAB does not accept the offer, the directors of BNZ may offer the shares to any person. There are no restrictions in BNZ's constitution on changes in capital, rights to own securities or restrictions on foreign shareholders.

There is no shareholding qualification for directors of BNZ and no mandatory retirement age. NAB has the power to fix each director's remuneration and BNZ may give such indemnities as the directors of BNZ deem appropriate. Directors of BNZ are appointed and removed by NAB.

BNZ's constitution dictates that a director who is interested in a transaction to which BNZ is a party may attend a meeting of directors at which a matter relating to the transaction arises and be included among the directors present at the meeting for the purposes of a quorum but, subject to certain exceptions set out in the constitution, will not vote on the matter nor be present while the matter is being considered at the meeting.

Under the Companies Act, directors who are interested in a transaction of a company are required to disclose their interest. Failure to disclose this interest will not affect the validity of the transaction or the ability of the director to attend and vote at the relevant directors' meeting. However, the director can be personally liable and if the company does not receive fair value under the transaction, the transaction may be voided within three months of its disclosure to all shareholders of the company.

In regard to shareholders, the power to:

- alter, revoke or adopt a new constitution,
- approve a major transaction, or
- approve an amalgamation, put BNZ into liquidation or apply for the removal of BNZ from the register of companies,

must be exercised by special resolution of the shareholders under the Companies Act. All other powers reserved to shareholders may be exercised by an ordinary resolution of shareholders. Resolutions can be passed at a meeting of shareholders or pursuant to a written resolution in lieu of a meeting.

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