Registered Bank Disclosure Statement

For the year ended 30 June 2021

Number 73

Disclosure statement

For the year ended 30 June 2021

This Disclosure Statement has been issued by Kiwibank Limited (the "**Bank**" or "**Kiwibank**") for the year ended 30 June 2021 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "**Order**").

In this Disclosure Statement, unless the context requires otherwise:

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

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General matters

Details of incorporation

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

Registered office

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

Address for service

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

Ultimate holding company

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

Voting securities and power to appoint directors

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

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

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

Other material matters

The Board of Directors of Kiwibank (the "**Board**") are of the opinion that there are no matters relating to the business or affairs of Kiwibank or the Banking Group which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which Kiwibank or any member of the Banking Group is the issuer.

Pending proceedings or arbitration

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

Priority of creditors' claims

In the event of the liquidation of Kiwibank, claims of secured creditors and those creditors set out in Schedule 7 of the Companies Act 1993 would rank ahead of the claims of unsecured creditors. Customer deposits are unsecured and rank equally with other unsecured liabilities of the Bank, and such liabilities rank ahead of any subordinated instruments issued by the Bank. The priority of creditors are covered in note 18, 19 and 20.

In addition, all payment obligations of Kiwibank covered by the NZP Guarantee that existed at the time the NZP Guarantee was terminated on 28 February 2017 are guaranteed under the NZP Guarantee but only in relation to and to the extent of those obligations.

General matters continued

Directorate

INDEPENDENT NON-EXECUTIVE DIRECTOR, CHAIR

Jonathan Peter Hartley
Qualifications: BA (Hons), FCA, ACA, FAICD
Primary occupation: Company director
Country of residence: New Zealand
Audit and Risk Committee member: Yes

External Directorship: Director of Timberlands Limited.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Kevin Mark Malloy
Qualifications: Dip Advertising & Marketing
Primary occupation: Company director
Country of residence: New Zealand
Audit and Risk Committee member: No

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

Mary Jane Daly (appointed on 31 August 2020)
Qualifications: BCom, MBA, CFInstD
Primary occupation: Company director
Country of residence: New Zealand
Audit and Risk Committee member: Yes (Chair)

External Directorships: Director of each of Kiwi Property Group Limited, FSF Management Company Limited, Earthquake Commission, Auckland Transport.

Ian Cameron Blair
Primary occupation: Managing Director
Country of residence: New Zealand
Audit and Risk Committee member: Yes

External Directorships: Director of each of Sapience Limited, WSP New Zealand Limited, Golder Construction (NZ) Limited, Golder Associates (NZ) Limited.

NON-EXECUTIVE DIRECTORS

Carol Anne Campbell
Qualifications: BCom, FCA, ChMInstD
Primary occupation: Company director
Country of residence: New Zealand
Audit and Risk Committee member: Yes

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

John Gilbert Sproat
Qualifications: BA, LLB (Hons)
Primary occupation: Company director
Country of residence: New Zealand
Audit and Risk Committee member: No

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

General matters continued

Directorate continued

NON-EXECUTIVE DIRECTORS CONTINUED

Scott John Pickering

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

Primary occupation: Company director

Country of residence: New Zealand

Audit and Risk Committee member: No

External Directorships: Director of Engage Consulting Limited.

CHANGES IN BOARD OF DIRECTORS

Alistair Bruce Ryan resigned as a director and Chair of the Finance, Audit and Disclosure Committee on 30 August 2020.

Mary Jane Daly was appointed as a director and Chair of the Audit and Risk Committee on 31 August 2020.

Michael Charles John O'Donnell resigned as a director on 15 November 2020.

AUDIT AND RISK COMMITTEE

The Finance, Audit and Disclosure Committee was renamed the Audit and Risk Committee on 31 August 2020. The Risk, Credit and Compliance Committee was combined with the Audit and Risk Committee on 21 October 2020.

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

EXECUTIVE DIRECTORS

There are no executive directors of the Bank.

COMMUNICATIONS WITH DIRECTORS

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

POLICY FOR AVOIDING AND DEALING WITH CONFLICTS OF INTEREST

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

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

a) the nature and monetary value of the director's interest in a transaction or proposed transaction if its monetary value is able to be quantified; or

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

DIRECTORS' BENEFITS

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

AUDITOR

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

Credit ratings

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

Rating agency	Current credit rating	Rating outlook
Moody's Investors Service ("**Moody's**")	A1	Outlook Stable
Fitch Ratings ("**Fitch**")	AA	Outlook Stable

RECENT RATING ACTIONS AND CHANGES IN CREDIT RATINGS

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

S&P

- On 13 July 2021, Kiwibank announced that, following agreement with S&P, the credit rating service would be ending. As a result S&P's ratings of Kiwibank have been withdrawn.
- On 6 May 2020, S&P affirmed Kiwibank's credit rating at A and changed the rating outlook from positive to stable.

Moody's

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

Fitch

- On 18 May 2020 and 19 October 2020, Fitch affirmed Kiwibank's credit rating at AA with a stable outlook for senior unsecured debt obligations payable in New Zealand dollars, and a credit rating of AA- with a positive outlook for senior unsecured debt obligations payable in other currencies.
- On 30 January 2020, Fitch affirmed Kiwibank's credit rating at AA with a stable outlook for senior unsecured debt obligations payable in New Zealand dollars. Fitch also affirmed Kiwibank's credit rating at AA- for senior unsecured debt obligations payable in other currencies and revised the outlook from stable to positive.

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

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

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

Guarantees

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

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

COVERED BOND GUARANTEE

Certain debt securities ("**Covered Bonds**") issued by the Bank are guaranteed by Kiwi Covered Bond Trustee Limited (the "**Covered Bond Guarantor**"), solely in its capacity as Trustee of Kiwi Covered Bond Trust. No material conditions apply to the Covered Bond Guarantee other than non-performance by Kiwibank. There are no material legislative or regulatory restrictions in New Zealand which would have the effect of subordinating the claims under the guarantee of any creditors of the Banking Group on the assets of the Covered Bond Guarantor, to other claims on the Covered Bond Guarantor, in a winding up of the Covered Bond Guarantor. The Covered Bond Guarantee will remain in force until all moneys payable under the Covered Bond Guarantee have been paid.

The Covered Bond Guarantor's guarantee is limited to the payment of interest on and the principal of Covered Bonds, and such guarantee is secured over a pool of assets. There are no other limits on the amount of obligations guaranteed. The carrying value and approximate fair value of the Kiwi Covered Bond Trust pool at 30 June 2021 is $700m (30 June 2020: $316m).

The Covered Bond Guarantor's address for service is Level 9, 34 Shortland Street, Auckland 1010, New Zealand. The Covered Bond Guarantor is not a member of the Banking Group and has no applicable credit rating. The Covered Bonds have been assigned a long-term rating of Aaa and AAA by Moody's and Fitch respectively.

NZP GUARANTEE

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

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

i) The address for service of NZP is: Ground Floor, New Zealand Post House, 7 Waterloo Quay, Wellington 6011, New Zealand.

ii) NZP is not a member of the Banking Group (as that term is defined in the Order).

iii) The NZP Guarantee is an unsecured guarantee of all the payment obligations (excluding any payment obligations, the terms of which expressly provide in writing that they do not have the benefit of the NZP Guarantee) of Kiwibank owing as at 28 February 2017 and still outstanding. The NZP Guarantee has no expiry date in relation to the payment obligations that continue to be guaranteed.

iv) There are no material legislative or regulatory restrictions in New Zealand which would have the effect of subordinating the claims under the NZP Guarantee of any of the creditors of Kiwibank on the assets of NZP, to other claims on NZP, in a winding up of NZP. The net tangible assets of NZP were $680m as calculated from NZP's most recent publicly available audited financial statements for the year ended 30 June 2020 (there were no modifications in the audit report accompanying the NZP Annual Report). The net tangible assets are also disclosed in the Directors' Report in the NZ Post Group Finance Limited Annual Report for the year ended 30 June 2020.

NZP has a credit rating applicable to its long-term unsecured obligations payable in New Zealand, in New Zealand dollars, from S&P of A with a stable outlook. On 9 June 2020, S&P affirmed NZP's credit rating at A with a stable outlook. On 19 December 2019, S&P lowered NZP's credit rating to A with a stable outlook from A+ with a negative outlook. On 1 October 2019, S&P affirmed NZP's credit rating at A+ and lowered the outlook from stable to negative. There have been no other changes in NZP's credit rating in the two years prior to signing date.

S&P's credit rating scale is consistent with the scale provided for Fitch on the previous page.

Directors' statement

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

1. As at the date on which the Disclosure Statement is signed:

   i) the Disclosure Statement contains all the information that is required by the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended); and

   ii) the Disclosure Statement is not false or misleading.

2. During the year ended 30 June 2021:

   i) Kiwibank has complied in all material respects with the conditions of registration applicable during the period;

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

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

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

Signed by Jonathan Peter Hartley and Mary Jane Daly as directors and responsible persons on behalf of all the directors listed in the Directorate of this Disclosure Statement.

25 August 2021

Historical summary of financial statements

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20[1]	Year ended 30/06/19	Year ended 30/06/18	Year ended 30/06/17
Financial performance					
Interest income	**761**	894	933	879	831
Interest expense	**(233)**	(439)	(488)	(468)	(463)
Net gains on financial instruments	**8**	13	3	9	8
Other operating income	**41**	65	90	119	118
Operating expenses	**(422)**	(408)	(375)	(373)	(339)
Credit impairment reversals/(losses)	**19**	(51)	(12)	(1)	6
Other impairment losses	**-**	-	-	(11)	(90)
Profit before taxation	**174**	74	151	154	71
Income tax expense	**(48)**	(17)	(43)	(39)	(18)
Profit after taxation	**126**	57	108	115	53
Profit after taxation attributable to non-controlling interests	**-**	-	-	-	-
Dividends paid to non-controlling interest	**-**	-	-	-	(1)
Dividends paid on ordinary shares	**(6)**	(17)	(25)	-	(5)
Distributions to holders of perpetual capital	**(6)**	(11)	(11)	(11)	(12)
Dividends paid to holders of perpetual shares	**-**	-	-	-	-

[1] In the current period, the Banking Group has renamed ‘Net fee and other income’ to ‘Other operating income’, and reclassified certain operating expenses to direct fee expenses or to net amounts against gross revenue within ‘Other operating income’. Comparatives have been reclassified as follows to align with the current year’s presentation: ‘Operating expenses’ and ‘Other operating income’ have decreased by $20m for the year ended 30 June 2020. Comparative periods 30 June 2017 to 30 June 2019 have not been reclassified.

Dollars in millions	**As at 30/06/21**	As at 30/06/20[2]	As at 30/06/19	As at 30/06/18	As at 30/06/17
Balance sheet					
Total assets	**28,229**	25,518	22,734	20,715	20,616
Of which individually impaired assets	**1**	2	5	10	12
Total liabilities	**26,505**	23,948	21,185	19,228	19,236
Equity attributable to owners of parent	**1,724**	1,570	1,549	1,487	1,380
Non-controlling interest	**-**	-	-	-	-

[2] In the current period, when the provision for credit impairment exceeds the carrying amount of drawn balances, the excess has been presented as ‘Other liabilities’ to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year’s presentation. Therefore ‘Total assets’ and ‘Total liabilities’ as at 30 June 2020 have increased by $8m. Comparative periods 30 June 2017 to 30 June 2019 have not been restated.

The amounts included in this summary have been taken from the audited financial statements of the Banking Group.

Financial statements

Income statement

For the year ended 30 June 2021

Dollars in millions	Note	Year ended 30/06/21	Year ended 30/06/20[1]
Interest income	3	**761**	894
Interest expense	3	**(233)**	(439)
Net interest income		**528**	455
Net gains on financial instruments	4	**8**	13
Other operating income	5	**41**	65
Total operating income		**577**	533
Operating expenses	6	**(422)**	(408)
Profit before credit impairment and taxation		**155**	125
Credit impairment reversals/(losses)	9	**19**	(51)
Profit before taxation		**174**	74
Income tax expense	7	**(48)**	(17)
Profit after taxation		**126**	57

[1] In the current period, the Banking Group has renamed 'Net fee and other income' to 'Other operating income', and reclassified certain operating expenses to direct fee expenses or to net amounts against gross revenue within 'Other operating income'. Comparatives have been reclassified as follows to align with the current year's presentation: 'Operating expenses' and 'Other operating income' have decreased by $20m for the year ended 30 June 2020.

Statement of comprehensive income

For the year ended 30 June 2021

Dollars in millions	Note	Year ended 30/06/21	Year ended 30/06/20
Profit after taxation		**126**	57
Other comprehensive income			
Net gains/(losses) from changes in reserves that may subsequently be reclassified to profit or loss:			
- Fair value reserve (net of tax)	29	**(23)**	13
- Cash flow hedge reserve (net of tax)	29	**63**	(22)
Other comprehensive income for the year		**40**	(9)
Total comprehensive income for the year		**166**	48

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

Financial statements continued

Statement of changes in equity

For the year ended 30 June 2021

Dollars in millions	Note	Fully paid ordinary shares	Retained earnings	Fair value reserve	Cash flow hedge reserve	Total shareholder's equity
Balance at 30 June 2019		737	823	11	(22)	1,549
Balance adjusted for adoption of NZ IFRS 16		-	1	-	-	1
Opening balance at 1 July 2019		737	824	11	(22)	1,550
Year ended 30 June 2020						
Profit for the year		-	57	-	-	57
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		-	-	13	-	13
Cash flow hedges (net of tax)		-	-	-	(22)	(22)
Total other comprehensive income		-	-	13	(22)	(9)
Total comprehensive income		-	57	13	(22)	48
Transactions with owners						
Dividends paid on ordinary shares	29	-	(17)	-	-	(17)
Distributions to holder of perpetual capital	29	-	(11)	-	-	(11)
Balance at 30 June 2020		737	853	24	(44)	1,570
Year ended 30 June 2021						
Profit for the year		**-**	**126**	**-**	**-**	**126**
Other comprehensive income						
Movement in fair value of investment securities (net of tax)		**-**	**-**	**(23)**	**-**	**(23)**
Cash flow hedges (net of tax)		**-**	**-**	**-**	**63**	**63**
Total other comprehensive income		**-**	**-**	**(23)**	**63**	**40**
Total comprehensive income		**-**	**126**	**(23)**	**63**	**166**
Transactions with owners						
Dividends paid on ordinary shares	29	**-**	**(6)**	**-**	**-**	**(6)**
Distributions to holder of perpetual capital	29	**-**	**(6)**	**-**	**-**	**(6)**
Balance at 30 June 2021		**737**	**967**	**1**	**19**	**1,724**

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

Financial statements continued

Balance sheet

As at 30 June 2021

Dollars in millions	Note	30/06/21	30/06/20[1]
Assets			
Cash and cash equivalents	13	**715**	492
Due from related parties	30	**77**	77
Due from other financial institutions	14	**26**	105
Investment securities	15	**1,704**	1,895
Derivative financial instruments	16	**228**	434
Loans and advances	8	**25,207**	22,230
Property, plant and equipment		**51**	49
Right-of-use assets	28	**110**	95
Deferred taxation	7	**19**	43
Intangible assets	25	**50**	60
Other assets	26	**42**	38
Total assets		**28,229**	25,518
Total interest-earning and discount-bearing assets		***27,631***	*24,711*
Liabilities			
Due to other financial institutions	17	**718**	317
Due to related parties	30	**6**	7
Deposits and other borrowings	18	**22,399**	20,597
Derivative financial instruments	16	**195**	400
Debt securities issued	19	**2,544**	2,229
Lease liabilities	28	**119**	97
Other liabilities	27	**109**	151
Subordinated debt	20	**415**	150
Total liabilities		**26,505**	23,948
Total interest and discount-bearing liabilities		***21,492***	*19,930*
Shareholder's equity			
Share capital	29	**737**	737
Reserves	29	**987**	833
Total shareholder's equity		**1,724**	1,570
Total liabilities and shareholder's equity		**28,229**	25,518

[1] In the current period, when the provision for credit impairment exceeds the carrying amount of drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have increased by $8m.

The Board of Directors of Kiwibank Limited authorised these financial statements for issue on 25 August 2021.

Jonathan Peter Hartley

Mary Jane Daly

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

Financial statements continued

Cash flow statement

For the year ended 30 June 2021

Dollars in millions	Note	**Year ended 30/06/21**	Year ended 30/06/20
Cash flows from operating activities			
Interest received		**805**	932
Interest paid		**(305)**	(454)
Fees and other income received		**108**	164
Direct fee expenses paid		**(70)**	(96)
Operating expenses paid		**(374)**	(375)
Taxes paid		**(63)**	(21)
Net cash flows from operating activities before changes in operating assets and liabilities		**101**	150
Net changes in operating assets and liabilities			
Investment securities		**161**	(696)
Loans and advances		**(2,973)**	(1,853)
Balances due from related parties		**(1)**	6
Balances due from other financial institutions		**79**	(34)
Deposits and other borrowings		**1,871**	2,377
Balances due to other financial institutions		**(172)**	191
Net cash flows from operating activities		**(934)**	141
Cash flows from investing activities			
Purchase of property, plant and equipment		**(14)**	(10)
Purchase of intangible assets		**(15)**	(12)
Net cash flows from investing activities		**(29)**	(22)
Cash flows from financing activities			
Repurchase agreements		**573**	-
Issue of debt securities	19	**1,456**	1,627
Redemption of debt securities	19	**(1,093)**	(1,537)
Payment of principal portion of lease liability	28	**(14)**	(12)
Receipt of lease incentive		**6**	-
Issue of subordinated debt net of issuance costs	20	**272**	-
Repayment of subordinated debt	20	**-**	(100)
Dividends paid on ordinary shares		**(6)**	(17)
Distributions to holders of perpetual capital		**(6)**	(11)
Net cash flows from financing activities		**1,188**	(50)
Increase in cash and cash equivalents		**225**	69
Cash and cash equivalents at beginning of the year		**492**	421
Effect of exchange translation adjustments		**(2)**	2
Cash and cash equivalents at end of the year	13	**715**	492

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

Financial statements continued

Cash flow statement continued

For the year ended 30 June 2021

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Reconciliation of profit after taxation to net cash flows from operating activities		
Profit after taxation	**126**	57
Non-cash movements and non-operating activities		
Unrealised fair value adjustments	**(5)**	(9)
Depreciation	**28**	26
Amortisation	**26**	26
Decrease in deferred expenditure	**39**	38
Movement in contract liabilities	**-**	(17)
Movement in provision for credit impairment	**(31)**	46
Lending losses written off	**13**	5
Intangible work in progress written off or impaired	**-**	6
Movement in interest	**(67)**	(16)
Movement in current and deferred tax	**(15)**	(4)
Other non-cash movements	**(13)**	(8)
Decrease/(increase) in operating assets		
Investment securities	**161**	(696)
Loans and advances	**(2,973)**	(1,853)
Balances due from other financial institutions	**79**	(34)
(Decrease)/increase in operating liabilities		
Deposits and other borrowing	**1,871**	2,377
Balances with related parties	**(1)**	6
Balances due to other financial institutions	**(172)**	191
Net cash flows from operating activities	**(934)**	141

Notes to the financial statements

1. Corporate information

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

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

These financial statements for the year ended 30 June 2021 have been approved for issue by the Board of Directors on 25 August 2021.

2. Basis of preparation and general accounting policies

2.1 Basis of accounting

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

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

Measurement base

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

Accounting period and comparative amounts

These audited financial statements are for the year ended 30 June 2021. Comparative amounts are from the audited financial statements for the year ended 30 June 2020. Certain amounts in the comparative information have been reclassified or amended to ensure consistency with the current period's presentation. Changes are disclosed within the primary financial statements and impacted notes where relevant.

2.2 Critical accounting judgements, estimates and assumptions

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

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

- Note 9 Measurement of expected credit losses
- Note 25 Impairment testing of non-financial assets.

The specific impact of the COVID-19 pandemic is relevant to the measurement of expected credit losses as detailed in Note 9.

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.3 Basis of consolidation

The consolidated financial statements comprise the financial statements of Kiwibank and its subsidiaries for the year ended 30 June 2021. Subsidiaries are entities that are controlled by the Banking Group. Control is achieved when the Banking Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically the Banking Group controls an investee if, and only if, the Banking Group has:

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

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

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

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

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

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

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

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

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

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

2.4 Associates and joint arrangements

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

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

2.5 New Accounting Standards and Interpretations

In the current year, the Banking Group applied amendments to Accounting Standards and Interpretations that are effective for an annual period that begins on or after 1 July 2020. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

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

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.5 New Accounting Standards and Interpretations continued

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

Standard	Effective for annual reporting periods beginning on or after:
Interest Rate Benchmark Reform – Phase 2: *Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16*	1 January 2021

Interest Rate Benchmark Reform – Phase 2

Background

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

In November 2019, the External Reporting Board ("**XRB**") issued phase 1 of the Interest Rate Benchmark Reform, which was early adopted by the Banking Group from 1 July 2019.

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

In September 2020, the XRB issued Interest Rate Benchmark Reform – Phase 2 effective for reporting periods beginning on or after 1 January 2021. These Phase 2 amendments complement the amendments adopted by the Banking Group in the year ended 30 June 2020.

Phase 2 addresses issues that might affect financial reporting when an existing interest rate benchmark is replaced by an alternative benchmark interest rate. The International Accounting Standards Board ("**IASB**") amended requirements to IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases* relating to:

- changes in the basis for determining contractual cash flows of financial assets, financial liabilities and lease liabilities;
- hedge accounting; and
- disclosures.

The Banking Group continues to monitor the developments and expected impacts of the Interest Rate Benchmark Reform. There is no financial impact of the Interest Rate Benchmark Reform for the Banking Group because the relevant hedging instruments and hedged instrument will be repriced with the same equivalent alternative benchmark interest rate when the existing interest rate benchmark is replaced.

Configuration or customisation costs in a cloud computing arrangement

In March 2019, the IFRS Interpretations Committee ("**IFRIC**") released guidance concluding that software-as-a-service ("**SaaS**") arrangements are likely to be service arrangements rather than intangible assets. In April 2021, the IFRIC released further guidance concluding that customisation and configuration costs in SaaS arrangements would not create an intangible asset because the software isn't controlled and these activities don't create a separate resource. The guidance applies retrospectively.

Customisation and configuration costs are described in the guidance as costs involved in:

- modifying the software code in the application or writing additional code.
- the setting of various 'flags' or 'switches' within the application software, or defining values or parameters, to set up the software's existing code to function in a specified way.

Management has performed an assessment of the impact on historical SaaS projects and has concluded that the impact of the guidance is not material to the financial statements.

2.6 Financial instruments

Recognition

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

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

Notes to the financial statements continued

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Derecognition

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

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

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

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

Classification

Financial assets

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

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

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

Financial assets in this category include cash and cash equivalents, due from related parties, due from other financial institutions, loans and advances, and other financial assets.

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

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

Financial assets in this category include investment securities.

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

All other financial assets are classified as measured at FVTPL.

Financial assets in this category include derivative financial instruments and other assets.

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

Reclassifications

Financial assets

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

Financial liabilities

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

2. Basis of preparation and general accounting policies continued

2.6 Financial instruments continued

Designation at fair value through profit or loss

Financial assets

On initial recognition, the Banking Group may elect to designate financial assets as at FVTPL because this designation eliminates or significantly reduces an accounting mismatch, that would otherwise arise. As at 30 June 2021, the Banking Group has not elected to designate any financial assets as at FVTPL on initial recognition (30 June 2020: nil).

Financial liabilities

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

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

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

2.7 Currency

Functional and presentation currency

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

Foreign currency translation

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

2.8 Provisions

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

2.9 Cash flow statement

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

i) Cash and cash equivalents is considered to be cash on hand, current accounts in banks, ATMs and overnight bank deposits, net of bank overdrafts and inter-bank balances arising from the daily RBNZ settlement process.

ii) Investing activities are those relating to the acquisition, holding and disposal of property, plant and equipment, intangibles, and other long-term assets.

iii) Financing activities are those activities that result in changes in the size and composition of the capital structure of the Banking Group. This includes both equity and debt not falling within the definition of cash. Repurchase agreements related to the Funding for Lending Programme and the Term Lending Facility have been included as financing activies.

iv) Operating activities include all transactions and other events that are not investing or financing activities. The holding of investment securities has been classified as an operating activity for the purposes of the cash flow statement.

v) Certain cash flows have been netted to provide more meaningful disclosure, including changes in loans and advances to customers, deposits held by customers, balances with other banks, investment securities, and financial assets held for trading. Many of the cash flows are received and disbursed on behalf of customers and reflect the activities of the customers rather than those of the Banking Group.

2.10 Other accounting policies

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

3. Interest income and expense

Accounting policy

Recognition of interest income and expense

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

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

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

Recognition of loan-related fees and costs

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

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

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Interest income		
Cash and cash equivalents	**1**	3
Due from other financial institutions	**-**	3
Loans and advances	**741**	863
Investment securities	**19**	25
Total interest income	**761**	894
Interest expense		
Due to other financial institutions	**1**	1
Deposits and other borrowings	**186**	376
Debt securities issued	**36**	54
Subordinated debt	**4**	1
Lease liabilities	**3**	2
Other interest expense	**3**	5
Total interest expense	**233**	439

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

3. Interest income and expense continued

Interest income and expense by measurement category

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Interest income		
Financial assets measured at amortised cost	**795**	904
Financial assets measured at FVOCI	**19**	25
Financial assets measured at FVTPL and used for hedging	**(53)**	(35)
Total interest income	**761**	894
Interest expense		
Financial liabilities measured at amortised cost	**235**	436
Financial liabilities measured at FVTPL and used for hedging	**(2)**	3
Total interest expense	**233**	439

4. Net gains on financial instruments

Accounting policy

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

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Net ineffectiveness on qualifying fair value hedges	**-**	1
Cumulative gain transferred from fair value reserve	**4**	3
Cumulative gain on financial liabilities at amortised cost	**-**	3
Net foreign exchange gains	**4**	6
Total net gains on financial instruments	**8**	13

Net ineffectiveness on qualifying cash flow hedges was insignificant (2020: same). Net ineffectiveness on qualifying fair value hedges was $0.3m (2020: $0.4m).

5. Other operating income

Accounting policy

Other operating income is recognised as services are performed and the related performance obligations are fulfilled.

Principal vs Agent

The Banking Group is required to determine whether it is a principal or an agent on the basis of whether the goods or services are provided by the Banking Group itself or are provided by another entity (i.e. does the Banking Group control the provision of the goods or services).

Where the Banking Group has determined it is an agent the revenue and expenses related to the goods or services have been recorded net in 'Gross fee and other income'.

Performance obligations and timing of revenue recognition

The transaction price for contracts with customers, including any estimated variable consideration, is allocated to each distinct performance obligation within each contract and revenue is recognised as those performance obligations are fulfilled. The allocation of the transaction price to a performance obligation is based on the exact terms of the contract or, in the absence of exact terms, an appropriate method is used to estimate the price such as an adjusted market assessment approach, expected cost plus a margin approach, the residual approach, or a combination of these methods.

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

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

DISAGGREGATION OF REVENUE FROM CONTRACTS WITH CUSTOMERS

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

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

5. Other operating income continued

In the following table, revenue from contracts with customers in the scope of NZ IFRS 15 is further disaggregated by the type of service provided to customers.

	Year ended 30/06/21			Year ended 30/06/20[1]		
Dollars in millions	**Personal**	**Business**	**Total**	Personal	Business	Total
Major service categories						
Lending services	**4**	**4**	**8**	6	4	10
Card services	**63**	**1**	**64**	76	1	77
Transactional account and other services	**30**	**6**	**36**	32	8	40
Total revenue from contracts with customers	**97**	**11**	**108**	114	13	127
Other income	**2**	**1**	**3**	12	-	12
Gross fee and other income	**99**	**12**	**111**	126	13	139
Direct fee expenses	**(69)**	**(1)**	**(70)**	(72)	(2)	(74)
Total other operating income	**30**	**11**	**41**	54	11	65

[1] In the current period, the Banking Group has renamed 'Net fee and other income' to 'Other operating income', and reclassified certain operating expenses to direct fee expenses or to net amounts against gross revenue within 'Other operating income'. Comparatives have been reclassified as follows to align with the current year's presentation: 'Gross fee and other income' has decreased by $42m and 'Direct fee expenses' have decreased by $22m for the year ended 30 June 2020.

The Banking Group sold the Prezzy card business to epay New Zealand Limited (epay) on 29 November 2019 with a transitional agreement in place whereby Kiwibank operated parts of the business on behalf of epay for an ongoing fee until epay could take on the full operation and issuance of the cards. On 27 November 2020 the full operation and issuance of Prezzy cards was transitioned to epay. The marketing and distribution of the Prezzy card was managed by epay from the sale date. There was no income recognised in relation to the gain on sale of Prezzy card during the year ended 30 June 2021 (30 June 2020: $12m).

The Banking Group held insurance policies at the date of the Kaikōura earthquake that provided for cover for Material Damage and Business Interruption. During the year ended 30 June 2021, $2.7m related to GST recovery was recognised within other income in relation to insurance claims for damages suffered and losses incurred as a result of the Kaikōura earthquake on 14 November 2016 (30 June 2020: $nil).

Notes to the financial statements continued

6. Operating expenses

Accounting policy

Operating expense recognition

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

Employee benefits

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

Leases

The Banking Group recognises the depreciation expense related to right-of-use assets within operating expenses and interest costs related to lease liabilities within interest expense. Refer to Note 28 for more detail on the accounting policy for leases.

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20[1]
Salaries and wages	**213**	186
Other personnel-related costs	**20**	23
Leasing and premises costs	**16**	12
Information technology and system costs	**61**	54
Office supplies, postage and phone	**9**	11
Consultancy and professional fees	**19**	23
Marketing and customer communications	**18**	18
Amortisation of intangible assets	**25**	22
Depreciation	**12**	12
Depreciation on right-of-use assets	**16**	14
Other expenses	**13**	33
Total operating expenses	**422**	408

[1] In the current period, the Banking Group reclassified certain operating expenses to direct fee expenses or to net amounts against gross revenue within 'Other operating income'. Comparatives have been reclassified as follows to align with the current year's presentation: 'Operating expenses' have decreased by $20m for the year ended 30 June 2020.

A total of $13.1m of operating expenses recognised during the year ended 30 June 2021 related to research and development expenditure classified in accordance with NZ IAS 38.

Included within salaries and wages is $8.9m of expenses paid to defined contribution plans for the year ended 30 June 2021 (30 June 2020: $8.2m).

Dollars in thousands	**Year ended 30/06/21**	Year ended 30/06/20
Directors' fees	**932**	956

Notes to the financial statements continued

7. Taxation

Accounting policy

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

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

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

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

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

Income tax expense

Dollars in millions	Year ended 30/06/21	Year ended 30/06/20
Profit before taxation	**174**	74
Tax calculated at a rate of 28%	**(49)**	(21)
Tax effect of:		
Income not subject to tax and non-deductible expenses	**-**	(1)
Transfer of tax losses from other KGHL subsidiaries	**1**	5
Tax charge as per the income statement	**(48)**	(17)
Represented by:		
Current income tax	**(48)**	(32)
Deferred income tax	**-**	15
Tax charge as per the income statement	**(48)**	(17)
The deferred tax charge in the income statement comprises the following temporary differences:		
Accelerated tax depreciation	**5**	2
Other provisions and accruals	**2**	-
Allowances for credit and other impairment losses	**(7)**	13
Total movement in temporary differences	**-**	15

Notes to the financial statements continued

7. Taxation continued

Deferred taxation

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Deferred tax		
Balance at beginning of the year	**43**	21
Prior period adjustment	**-**	(1)
Movement in temporary differences	**-**	16
Tax on profits taken to reserves	**(24)**	7
Balance at end of the year	**19**	43
Deferred income tax assets		
Cash flow hedges	**-**	16
Other provisions and accruals	**10**	8
Allowance for loan impairment	**17**	24
Total deferred income tax assets	**27**	48
Deferred income tax liabilities		
Accelerated tax depreciation	**-**	(5)
Cash flow hedges	**(8)**	-
Total deferred income tax liabilities	**(8)**	(5)
Net deferred taxation	**19**	43

Imputation credit account

The Banking Group is a member of the Kiwi Group Holdings Limited consolidated tax group and consequently does not maintain an imputation credit account.

8. Loans and advances

Accounting policy

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

The following table presents gross loans and advances by type of product. Total gross residential mortgage loans at 30 June 2021 were $22,481m (2020: $20,315m). This includes *term loans – housing* and residentially secured lending within *other term lending* (see Note 10).

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20[1]
Overdrafts	**106**	107
Credit cards	**377**	389
Term loans – housing	**21,505**	19,377
Other term lending	**3,041**	2,234
Other lending	**232**	201
Gross loans and advances	**25,261**	22,308
Provision for credit impairment	**(54)**	(78)
Net loans and advances	**25,207**	22,230
Contractual maturity:		
Current	**1,735**	1,517
Non-current	**23,472**	20,713

[1] In the current period, when the provision for credit impairment exceeds the carrying amount of drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have increased by $8m.

Business Finance Guarantee Scheme

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

On 13 April 2020, the Bank entered into a deed of indemnity with the Crown to implement the Scheme. The Scheme allowed the Bank to lend up to $500,000 to qualifying borrowers for a maximum of three years.

On 20 August 2020, the Bank entered into a new deed of indemnity allowing the Bank to lend up to $5m to qualifying borrowers for a maximum of five years. Subject to compliance with the terms of the deed, the Crown will pay 80% of any loss incurred by the Bank on loans made under this scheme, with the remaining 20% carried by the Bank. There are no other limits on the amount of the obligations guaranteed.

On 15 December 2020, a new deed of indemnity was executed extending the availability period to 30 June 2021. While a number of new conditions were agreed, including changes to the refinancing clauses, the Crown have maintained their 80% loss sharing agreement on compliant loans.

The amount of loans issued under this scheme are disclosed within Note 9.

Notes to the financial statements continued

9. Credit impairment losses

Accounting policy

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

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

In accordance with Orders in Council, and aligned with categories under Capital Adequacy BS2A definitions, loans and advances are classified as:

- retail unsecured lending (other exposures excluding exposures to sovereigns and central banks, multilateral development banks and other international organisations, public sector entities, and banks);
- residential mortgages; and
- business exposures (corporate exposures).

Measurement of ECL

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

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

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

Stage 3: This stage comprises all accounts that are impaired or in default. Lifetime ECL is recognised for loans where there is objective evidence of impairment. Where an economic loss is expected, a specific provision is raised which is calculated as the difference between contracted cash flows and the estimated realisable value of the security.

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

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

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

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

Changes to ECL are assessed through four economic scenarios:

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

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

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

Credit-impaired financial assets

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

Notes to the financial statements continued

9. Credit impairment losses continued

Accounting policy continued

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

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

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

Presentation of allowance for ECL in the balance sheet

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

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

Write-off

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

Recoveries of amounts previously written off are included in 'Credit impairment losses' in the income statement.

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

Critical accounting estimates and judgements

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

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

- modelling inputs – PD, EAD, LGD attrition rates and product maturity profiles
- the criteria under which exposures move between IFRS stages, particularly when moving to and from fully performing (stage 1) and demonstrating a significant increase in credit risk (stage 2)
- the macroeconomic inputs used within each of the economic scenarios
- the weightings given to each economic scenario
- any overlays required to estimate impairments due to potential loss events that could occur (such as natural disasters) as well as loss events that have occurred but where those impacts had not yet been incorporated into the ECL models.

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

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

9. Credit impairment losses continued

Dollars in millions	Year ended 30/06/21 Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Credited/(charged) to the income statement for collectively assessed provisions	**7**	**19**	**(3)**	**23**
Credited/(charged) to the income statement for individually assessed provisions	**-**	**1**	**(1)**	**-**
Amounts written off directly to the income statement	**(7)**	**-**	**-**	**(7)**
Recovery of amounts previously written off	**3**	**-**	**-**	**3**
Total credit impairment reversals/(losses) per income statement	**3**	**20**	**(4)**	**19**

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

SUMMARY OF IMPACT OF COVID-19 ON CREDIT IMPAIRMENT LOSSES AND CREDIT IMPAIRMENT PROVISIONS FOR THE YEAR ENDED 30 JUNE 2021

COVID-19 continues to have a material impact on New Zealand and other countries across the globe.

Kiwibank's experience of the credit and financial effects of COVID-19 has been that Kiwibank customers have successfully navigated through the short-term liquidity impacts while Business customers have adapted to the initial impacts on costs or revenue resulting from changes to business models or supply chains. The majority of Retail customers have also managed through temporary reductions in personal incomes as a result of COVID-19 and the resulting lockdowns so that most loans are now restored to their original terms.

The formal banking industry lending support programmes provided to COVID-19-impacted Retail customers ended on 31 March 2021. Kiwibank has reviewed the need for continuing support with each customer still receiving interest-only or deferred payment arrangements at that time. The majority of those customers have now transitioned those supported loans back to standard principal and interest loan terms. From a total of $1.9b of COVID-19-supported lending provided to 6,602 customers as at June 2020, the Bank is now only providing continuing loan support to a small number of customers as indicated in the table below. These remaining COVID-19-supported customers are now managed alongside those customers accessing loan support through the Hardship arrangements available to all Kiwibank customers experiencing some form of temporary financial stress.

The following table shows the total drawn exposure and number of customers provided with lending support packages related to COVID-19:

	As at 30/06/21		As at 30/06/20	
	Drawn exposure ($m)	Number of customers	Drawn exposure ($m)	Number of customers
COVID-19 Interest Only	**22**	**59**	1,063	3,147
COVID-19 Repayment Deferral	**-**	**1**	848	2,197
COVID-19 Term Extension	**4**	**15**	19	81
Credit Card Assistance	**-**	**80**	4	475
Retail Overdraft Package	**-**	**-**	-	651
Business Finance Guarantees	**108**	**178**	8	51
Total	**134**	**333**	1,942	6,602

As customers migrated from Stage 1 to Stage 2 or Stage 3, due to credit deterioration as a direct result of COVID-19, the additional ECL of $8m has been offset against the management overlay established in June 2020. The unutilised overlay of $12m was released during the year ended 30 June 2021.

Notes to the financial statements continued

9. Credit impairment losses continued

Summary of key changes in ECL provisions

Further analysis of the significant judgements and associated assumptions in relation to changes in model inputs, scenario weightings (included within ECL movements), and model overlays is detailed below. The following table summarises the movement in the provision for credit impairment for the year ended 30 June 2021:

Dollars in millions	Individually assessed provisions	Collectively assessed provisions		Total provision for credit impairment on loans	ECL on undrawn commitments	Total provision
		Modelled ECL	Model overlays			
As at 30 June 2020	2	50	26	78	8	86
Movement	**(1)**	**(5)**	**(18)**	**(24)**	**-**	**(24)**
As at 30 June 2021	**1**	**45**	**8**	**54**	**8**	**62**

Changes in ECL model assumptions and inputs

The modelled provision for expected credit losses is an estimate of forward-looking losses based on the Banking Group's view of four different economic scenarios. Kiwibank's assumptions around the macroeconomic factors used within each scenario and the weighting applied to each scenario are key judgements applied to the ECL models. The Banking Group has adjusted the macroeconomic variables used in the ECL model based on current economic forecasts. The weightings assigned to each scenario have been reassessed and reflect the reduced uncertainty and lower potential downside risks for the domestic economy compared to those applying at this time last year.

The Banking Group's four macroeconomic scenarios have been updated during the year ended 30 June 2021 as follows:

- **Central scenario:** this is the Banking Group's base case assumption which covers forward-looking credit risk against GDP, house prices, unemployment, interest rates and CPI. The base case assumes a continuing low-level impact of COVID-19 on the New Zealand economy into the medium term.
- **Upside scenario**: this scenario reflects more favourable macroeconomic conditions than the central scenario which leads to lower-than-expected credit losses. The upside scenario is a more positive outlook and assumes that COVID-19 will only have a short-term impact on the New Zealand economy.
- **Downside scenario**: this scenario reflects more unfavourable macroeconomic conditions than the central scenario. This scenario will lead to higher-than-expected credit losses reflecting a deterioration in the credit risk factors. The downside scenario assumes that New Zealand will enter another major lockdown as well as subsequent periodic lockdowns, and COVID-19 will have a long-term economic impact.
- **Severe stress scenario:** this scenario is based on the severe economic stress test scenarios that are used in regulator stress testing across several jurisdictions including New Zealand, Australia, the UK and the US. It reflects a more prolonged contraction to the economy and more severe impacts on house prices.

The changes in the variables and weighting used at 30 June 2021 compared to 30 June 2020 are presented on the following pages.

Notes to the financial statements continued

9. Credit impairment losses continued

Scenario		30/06/21	30/06/20
Central	**GDP**	Annual growth rebounds in 2021 before moderating to a range of 2.0 to 2.5% p.a. from 2023.	GDP falls 18.3% YoY in June 2020 quarter and doesn't return to 2020 levels until 2022.
	Unemployment	Unemployment reduces from 4.9% to 4.0% p.a. by the end of 2024.	Unemployment reduces slowly from 9.8% to 5.3% by 2023.
	House price index	Annual house price growth falls to 1.0% p.a. by the end of 2022 before returning to an annual growth rate of 4 to 4.5% p.a. from late 2023 onwards.	House prices fall ~10% from pre-lockdown levels and are slow to recover.
Upside	**GDP**	Annual GDP growth rebounds in 2021 before moderating to 2.7% p.a. by start of 2024.	Economy recovers more quickly than in the Central scenario with GDP returning to 2020 levels by mid-2021.
	Unemployment	Unemployment declines from 4.9% to 3.5% by the end of 2023.	Unemployment peaks at 9% and then reduces slowly.
	House price index	Strong house price growth continues through 2022 before moderating to ~5.5% p.a. annual growth rate by the end of 2024.	House prices fall ~10% from pre-lockdown levels recovering by end of 2022.
Downside	**GDP**	After the 2021 rebound, GDP growth remains below 1% p.a. until mid-2022. Annual GDP grows at ~2.5% p.a. from 2024.	GDP recovers more slowly from COVID-19 due to a second (and subsequent) round of infection requiring further periods of lockdown.
	Unemployment	Unemployment increases marginally over the remainder of 2021 before recovering to ~4.0% by late 2024.	Unemployment peaks at 13.4% before falling slowly to <8% by the second half of 2023.
	House price index	Annual house price growth falls below 1% p.a. before returning to an annual growth of ~4.5% p.a. from mid-2024.	House prices fall ~20% from their peak and don't recover to pre-lockdown levels by 2023.
Severe stress	**GDP**	Annual average GDP growth falls to -2% p.a. by the second year of the scenario, not recovering to the starting level until the end of year 3.	Annual average GDP growth falls to -2% p.a. by the second year of the scenario, not recovering to the starting level until the end of year 3.
	Unemployment	Unemployment increases and peaks above 10%.	Unemployment increases and peaks above 10%.
	House price index	House prices decrease ~35% from their peak.	House prices decrease ~35% from their peak.

Changes in scenario weightings

The weightings applied to each scenario have been reviewed and are amended from the weightings applied at 30 June 2020. The weightings applied to the scenarios in the calculation of ECL as at 30 June 2021 are outlined below.

Scenario weighting applied	30/06/21	30/06/20
Central	**50%**	40%
Upside	**10%**	10%
Downside	**30%**	40%
Severe stress	**10%**	10%

The weightings as at 30 June 2021 reflect the latest assessment of downside risks which are currently considered to be significantly lower than those applying at 30 June 2020. That improvement in the profile for each scenario reflects the economic recovery experienced over the period as well as the improved near-term growth prospects for New Zealand and the majority of its larger trading partners. The downside and severe stress scenarios recognise the potential for breakdowns in current pandemic mitigation initiatives, a resurgence in the virus given the continuing global incidence of COVID-19, the identification of more infectious variants, and the possibility of delays in implementing vaccination programmes.

Notes to the financial statements continued

9. Credit impairment losses continued

Changes in model overlays

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

As at 30 June 2020, the majority of model overlays represented the expected impacts of COVID-19 on the Banking Group's ECL given assumptions made at the time of expected credit deterioration. As set out earlier, the Banking Group has reviewed the need for continuing COVID-19-related overlays and has determined they are no longer required given the broader economic recovery and the credit performance of the Banking Group's portfolios over recent months. The direct impacts on expected credit losses have now been incorporated into modelled ECL while any longer-term impacts will be picked up by the Banking Group's models through the usual indicators of a significant increase in credit risk, primarily arrears and defaults, as well as through changes to impairments.

The other model overlays recognise other situations where the Banking Group is unable to source the data to satisfactorily model the risks or where the modelling is inherently uncertain due to the nature of the risk.

Dollars in millions	**As at 30/06/21**	As at 30/06/20
COVID-19 model overlays		
Mortgage	**-**	14
Business	**-**	6
Other model overlays	**8**	6
Total model overlays	**8**	26

Of the mortgage and business overlays, $8m was offset against provision movements directly due to COVID-19 with the remaining $12m released.

Sensitivity of ECL to key judgements and assumptions

The economic and health threats posed by the COVID-19 pandemic have not yet passed, so the assumptions which underlay each scenario and the weightings applied may vary significantly from the actual track of the economy. Other events, including those with a low likelihood but a high impact on the economy and on credit losses, might also occur over the forecast period so that the actual economy might perform differently to the scenarios modelled. Those variances will result in an understatement or overstatement of the provision for credit impairment. Given this uncertainty, and as the impact of judgements is significant, a sensitivity analysis is included below to outline the impact of applying different scenario weightings and overlay assumptions on the level of ECL.

The following table outlines the sensitivity of ECL to the key factors used to determine provisions as at 30 June 2021. This sensitivity includes giving each economic scenario a 100% weighting, adjusting some model overlays to reflect those scenario conditions while holding all other modelling factors constant.

	Year ended 30/06/21		**Year ended 30/06/20**	
Dollars in millions	**Total ECL**	**Impact**	**Total ECL**	**Impact**
If 1% of stage 1 exposure transitions to stage 2	**67**	**5**	91	5
If 1% of stage 2 exposure transitions to stage 1	**62**	**-**	86	-
Reported probability-weighted ECL	**62**	**-**	86	-
100% upside scenario ECL	**43**	**(19)**	52	(34)
100% central scenario ECL	**55**	**(7)**	77	(9)
100% downside scenario ECL	**69**	**7**	99	13
100% severe stress ECL	**90**	**28**	112	26

Notes to the financial statements continued

10. Asset quality

Summary of lending

Dollars in millions	Year ended 30/06/21			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Neither past due nor impaired	**377**	**22,410**	**2,373**	**25,160**
Past due but not impaired	**14**	**71**	**15**	**100**
Impaired	**-**	**-**	**1**	**1**
Gross loans and advances	**391**	**22,481**	**2,389**	**25,261**
Provision for credit impairment	**(10)**	**(19)**	**(25)**	**(54)**
Fair value hedge adjustments	**-**	**-**	**-**	**-**
Net loans and advances	**381**	**22,462**	**2,364**	**25,207**

Dollars in millions	Year ended 30/06/20			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Neither past due nor impaired	392	20,253	1,556	22,201
Past due but not impaired	17	61	27	105
Impaired	-	1	1	2
Gross loans and advances	409	20,315	1,584	22,308
Provision for credit impairment[1]	(17)	(38)	(23)	(78)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	392	20,277	1,561	22,230

[1]In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have been increased by $8m.

Loans and advances past due but not impaired

Dollars in millions	Year ended 30/06/21			
	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Past due less than 30 days	**12**	**44**	**6**	**62**
Past due 30 – 59 days	**2**	**8**	**3**	**13**
Past due 60 – 89 days	**-**	**8**	**1**	**9**
Past due 90 days or greater	**-**	**11**	**5**	**16**
Total loans and advances past due but not impaired	**14**	**71**	**15**	**100**

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

Notes to the financial statements continued

10. Asset quality continued

Other asset quality information

Dollars in millions	30/06/21 Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Undrawn lending commitments to counterparties with individually impaired assets	-	-	-	-
Other assets under administration	-	-	2	2

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

Movement in provision for credit impairment and gross carrying amounts

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

The movement tables are presented on the following basis:

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

Notes to the financial statements continued

10. Asset quality continued

Movement in provision for credit impairment – retail unsecured lending

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – retail unsecured lending	8	9	2	-	19
Transfers between stages:					
- Transferred to Stage 1	3	(2)	(1)	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	2	(1)	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(3)	4	-	-	1
- Changes due to additions and deletions	-	(1)	(1)	-	(2)
- Changes due to amounts written off	-	(4)	-	-	(4)
- Other changes	(1)	(1)	-	-	(2)
Total (credited)/charged to income statement for collectively assessed provisions	(4)	(2)	(1)	-	(7)
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	-	-
Total provision for loans and commitments at end of the period – retail unsecured lending	6	6	-	-	12
Presented as:					
- Provision for credit impairment on loans	4	6	-	-	10
- Provision for credit impairment on undrawn commitments	2	-	-	-	2
Total provision for loans and commitments at end of the period – retail unsecured lending	6	6	-	-	12

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross carrying amount and credit commitments on ECL – retail unsecured lending

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – retail unsecured lending					
Balance at beginning of the period	**300**	**105**	**4**	**-**	**409**
Net transfers between stages	**12**	**(10)**	**(2)**	**-**	**-**
Additions	**102**	**33**	**1**	**-**	**136**
Deletions	**(118)**	**(27)**	**(2)**	**-**	**(147)**
Amounts written off	**-**	**(7)**	**-**	**-**	**(7)**
Gross carrying amount at end of the period – retail unsecured lending	**296**	**94**	**1**	**-**	**391**
Off-balance sheet credit commitments – retail unsecured lending					
Balance at beginning of the period	**932**	**35**	**-**	**-**	**967**
Net transfers between stages	**(5)**	**5**	**-**	**-**	**-**
Additions	**129**	**9**	**-**	**-**	**138**
Deletions	**(156)**	**(23)**	**-**	**-**	**(179)**
Off-balance sheet credit commitments at the end of period – retail unsecured lending	**900**	**26**	**-**	**-**	**926**

Significant changes in the gross carrying amount of retail unsecured loans that contributed to changes in the provision for credit impairment for the year ended 30 June 2021 are outlined below.

Credit impairment provisions on retail unsecured lending decreased by $7m:

- decrease in ECL due to a $59m reduction in gross retail unsecured lending exposures (-$2m),
- remeasurement of ECL as a result of exposures migrating to higher risk grades (+$1m),
- changes to economic scenarios and releases of model overlays (-$2m),
- $7m of gross balances that were written off from stage 2 (-$4m).

10. Asset quality continued

Movement in provision for credit impairment – residential mortgage loans

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – residential mortgage loans	32	5	2	1	40
Transfers between stages:					
- Transferred to Stage 1	2	(2)	-	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	(1)	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	3	1	-	3
- Changes due to additions and deletions	1	-	(1)	-	-
- Changes due to amounts written off	-	-	-	-	-
- Other changes	(22)	-	-	-	(22)
Total (credited)/charged to income statement for collectively assessed provisions	(22)	3	-	-	(19)
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	(1)	(1)
Amounts written off from individually assessed provisions	-	-	-	-	-
Total provision for loans and commitments at end of the period – residential mortgage loans	11	7	2	-	20
Presented as:					
- Provision for credit impairment on loans	10	7	2	-	19
- Provision for credit impairment on undrawn commitments	1	-	-	-	1
Total provision for loans and commitments at end of the period – residential mortgage loans	11	7	2	-	20

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross carrying amount and credit commitments on ECL – residential mortgage loans

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – residential mortgage loans					
Balance at beginning of the period	**19,645**	**654**	**15**	**1**	**20,315**
Net transfers between stages	**(180)**	**172**	**8**	**-**	**-**
Additions	**6,597**	**155**	**1**	**-**	**6,753**
Deletions	**(4,424)**	**(154)**	**(8)**	**(1)**	**(4,587)**
Amounts written off	**-**	**-**	**-**	**-**	**-**
Balance at end of the period –residential mortgage loans	**21,638**	**827**	**16**	**-**	**22,481**
Off-balance sheet credit commitments – residential mortgage loans					
Balance at beginning of the period	**2,224**	**27**	**-**	**-**	**2,251**
Net transfers between stages	**(8)**	**7**	**1**	**-**	**-**
Additions	**1,081**	**10**	**-**	**-**	**1,091**
Deletions	**(792)**	**(17)**	**(1)**	**-**	**(810)**
Off-balance sheet credit commitments at end of the period – residential mortgage lending	**2,505**	**27**	**-**	**-**	**2,532**

Significant changes in the gross carrying amount of residential mortgage loans that contributed to changes in the provision for credit impairment for the year ended 30 June 2021 are outlined below.

Credit impairment provisions on residential mortgage loans decreased by $20m:

- remeasurement of ECL as a result of exposures migrating to higher risk grades (+$3m),
- release of COVID-19 management overlays (-$14m),
- changes to the economic scenarios, model overlays and model changes (-$8m),
- release of individually assessed provisions (-$1m).

Notes to the financial statements continued

10. Asset quality continued

Movement in provision for credit impairment – business exposures

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of period – business exposures	16	7	3	1	27
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	-	-	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	3	-	-	2
- Changes due to additions and deletions	6	-	(2)	-	4
- Changes due to amounts written off	-	-	-	-	-
- Other changes	(1)	(2)	-	-	(3)
Total (credited)/charged to income statement for collectively assessed provisions	4	1	(2)	-	3
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	1	1
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Total provision for loans and commitments at end of period – business exposures	20	8	1	1	30
Presented as:					
- Provision for credit impairment on loans	16	7	1	1	25
- Provision for credit impairment on undrawn commitments	4	1	-	-	5
Total provision for loans and commitments at end of period – business exposures	20	8	1	1	30

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross carrying amount and credit commitments on ECL – business exposures

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – business exposures					
Balance at beginning of the period	**1,493**	**82**	**8**	**1**	**1,584**
Net transfers between stages	**(28)**	**25**	**2**	**1**	**-**
Additions	**1,269**	**26**	**2**	**1**	**1,298**
Deletions	**(448)**	**(36)**	**(7)**	**(1)**	**(492)**
Amounts written off	**-**	**-**	**-**	**(1)**	**(1)**
Balance at end of the period – business exposures	**2,286**	**97**	**5**	**1**	**2,389**
Off-balance sheet credit commitments – business exposures					
Balance at beginning of the period	**594**	**14**	**-**	**1**	**609**
Net transfers between stages	**(1)**	**1**	**-**	**-**	**-**
Additions	**611**	**6**	**-**	**-**	**617**
Deletions	**(356)**	**(6)**	**-**	**(1)**	**(363)**
Off-balance sheet credit commitments at end of the period – business exposures	**848**	**15**	**-**	**-**	**863**

Significant changes in the gross carrying amount of business exposures that contributed to changes in the provision for credit impairment for the year ended 30 June 2021 are outlined below.

Credit impairment provisions on business exposures increased by $3m:

- increase in ECL due to net growth in exposure and migration to higher risk grades (+$4m),
- remeasurement of ECL as a result of changes in credit risk (+$2m),
- release of COVID-19 business overlays (-$6m),
- changes to economic scenarios, and movement in management overlays (+$3m).

Notes to the financial statements continued

10. Asset quality continued

Movement in provision for credit impairment – total exposures

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – total exposures	56	21	7	2	86
Transfers between stages:					
- Transferred to Stage 1	6	(5)	(1)	-	-
- Transferred to Stage 2	(3)	3	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	3	(2)	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(5)	10	1	-	6
- Changes due to additions and deletions	7	(1)	(4)	-	2
- Changes due to amounts written off	-	(4)	-	-	(4)
- Other changes	(24)	(3)	-	-	(27)
Total (credited)/charged to income statement for collectively assessed provisions	(22)	2	(3)	-	(23)
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	(1)	(1)
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Total provision for loans and commitments at end of the period – total exposures	37	21	3	1	62
Presented as:					
- Provision for credit impairment on loans	30	20	3	1	54
- Provision for credit impairment on undrawn commitments	7	1	-	-	8
Total provision for loans and commitments at end of the period – total exposures	37	21	3	1	62

Notes to the financial statements continued

10. Asset quality continued

Impact of changes in gross carrying amount and credit commitments on ECL – total exposures

	Year ended 30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – total exposures					
Balance at beginning of the period	**21,438**	**841**	**27**	**2**	**22,308**
Net transfers between stages	**(196)**	**187**	**8**	**1**	**-**
Additions	**7,968**	**214**	**4**	**1**	**8,187**
Deletions	**(4,990)**	**(217)**	**(17)**	**(2)**	**(5,226)**
Amounts written off	**-**	**(7)**	**-**	**(1)**	**(8)**
Balance at end of the period – total exposures	**24,220**	**1,018**	**22**	**1**	**25,261**
Off-balance sheet credit commitments – total exposures					
Balance at beginning of the period	**3,750**	**76**	**-**	**1**	**3,827**
Net transfers between stages	**(14)**	**13**	**1**	**-**	**-**
Additions	**1,821**	**25**	**-**	**-**	**1,846**
Deletions	**(1,304)**	**(46)**	**(1)**	**(1)**	**(1,352)**
Off-balance sheet credit commitments at end of the period – total exposures	**4,253**	**68**	**-**	**-**	**4,321**

Notes to the financial statements continued

10. Asset quality continued

Restatement of prior periods

In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances, the excess has been accounted for under 'Other liabilities' and reflects the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have been increased by $8m.

The tables below have been updated to reflect this change through the addition of provision for credit impairment on undrawn commitments, and an off-balance sheet credit commitment table.

Commentary on the impact of significant changes in the gross carrying amounts on the provision for credit impairment have been simplified for the prior year to align with the current year's presentation.

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

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – retail unsecured lending	5	5	-	-	10
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	-	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	(1)	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	3	1	-	3
- Changes due to additions and deletions	2	3	1	-	6
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	1	1	-	-	2
Total (credited)/charged to income statement for collectively assessed provisions	2	5	2	-	9
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	-	-
Total provision for loans and commitments at end of the period – retail unsecured lending	8	9	2	-	19
Presented as:					
- Provision for credit impairment on loans	6	9	2	-	17
- Provision for credit impairment on undrawn commitments	2	-	-	-	2
Total provision for loans and commitments at end of the period – retail unsecured lending	8	9	2	-	19

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross carrying amount and credit commitments on ECL – retail unsecured lending

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – retail unsecured lending					
Balance at beginning of the period	311	119	1	-	431
Net transfers between stages	23	(25)	2	-	-
Additions	110	48	2	-	160
Deletions	(144)	(30)	(1)	-	(175)
Amounts written off	-	(7)	-	-	(7)
Gross carrying amount at end of the period – retail unsecured lending	300	105	4	-	409
Off-balance sheet credit commitments – retail unsecured lending					
Balance at beginning of the period	860	32	-	-	892
Net transfers between stages	(4)	3	1	-	-
Additions	207	18	-	-	225
Deletions	(131)	(18)	(1)	-	(150)
Off-balance sheet credit commitments at end of the period –retail unsecured lending	932	35	-	-	967

Significant changes in the gross carrying amount of retail unsecured loans that contributed to changes in the provision for credit impairment for the year ended 30 June 2020 are outlined below.

Credit impairment provisions on retail unsecured lending increased by $9m:

- increase in ECL due to net growth in credit card exposures (+$6m),
- remeasurement of ECL as a result of exposures migrating to higher risk grades (+$3m),
- changes to the economic scenarios (+$2m),
- $7m of gross balances that were written off from stage 2 (-$2m).

Notes to the financial statements continued

10. Asset quality continued

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

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – residential mortgage loans	8	3	3	2	16
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	1	(1)	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	-	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	1	1	-	1
- Changes due to additions and deletions	-	-	(1)	-	(1)
- Changes due to amounts written off	-	-	-	-	-
- Other changes	24	1	-	-	25
Total (credited)/charged to income statement for collectively assessed provisions	23	2	-	-	25
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	-	-
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	-	-
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Total provision for loans and commitments at end of the period – residential mortgage loans	32	5	2	1	40
Presented as:					
- Provision for credit impairment on loans	31	4	2	1	38
- Provision for credit impairment on undrawn commitments	1	1	-	-	2
Total provision for loans and commitments at end of the period – residential mortgage loans	32	5	2	1	40

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross carrying amount and credit commitments on ECL – residential mortgage loans

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – residential mortgage loans					
Balance at beginning of the period	18,263	610	18	3	18,894
Net transfers between stages	(47)	41	6	-	-
Additions	4,843	133	1	-	4,977
Deletions	(3,414)	(130)	(10)	(1)	(3,555)
Amounts written off	-	-	-	(1)	(1)
Balance at end of the period – residential mortgage loans	19,645	654	15	1	20,315
Off-balance sheet credit commitments – residential mortgage loans					
Balance at beginning of the period	2,093	21	-	-	2,114
Net transfers between stages	(7)	6	1	-	-
Additions	807	11	-	-	818
Deletions	(669)	(11)	(1)	-	(681)
Off-balance sheet credit commitments at end of the period – residential mortgage lending	2,224	27	-	-	2,251

Significant changes in the gross carrying amount of residential mortgage loans that contributed to changes in the provision for credit impairment for the year ended 30 June 2020 are outlined below.

Credit impairment provisions on residential mortgage loans increased by $24m:

- remeasurement of ECL as a result of exposures migrating to higher risk grades due to the impacts of COVID-19 (+$1m),
- net movement in ECL as a result of growth in stage 1 exposures was more than offset by reductions in stage 3 exposures (-$1m),
- changes to the economic scenarios (-$1m),
- an increase in management overlays for the credit deterioration expected following the impact of COVID-19 (+$25m).

Notes to the financial statements continued

10. Asset quality continued

Prior period movement in provision for credit impairment – business exposures

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – business exposures	6	6	1	1	14
Transfers between stages:					
- Transferred to Stage 1	1	(1)	-	-	-
- Transferred to Stage 2	-	-	-	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	1	(1)	-	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(1)	1	-	-	-
- Changes due to additions and deletions	4	-	2	-	6
- Changes due to amounts written off	-	-	-	-	-
- Other changes	6	1	-	-	7
Total (credited)/charged to income statement for collectively assessed provisions	9	2	2	-	13
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	1	1
Amounts written off from individually assessed provisions	-	-	-	(1)	(1)
Total provision for loans and commitments at end of the period – business exposures	16	7	3	1	27
Presented as:					
- Provision for credit impairment on loans	14	5	3	1	23
- Provision for credit impairment on undrawn commitments	2	2	-	-	4
Total provision for loans and commitments at end of the period – business exposures	16	7	3	1	27

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross carrying amount and credit commitments on ECL – business exposures

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – business exposures					
Balance at beginning of the period	1,102	52	2	2	1,158
Net transfers between stages	(26)	25	1	-	-
Additions	741	23	6	1	771
Deletions	(324)	(18)	(1)	(1)	(344)
Amounts written off	-	-	-	(1)	(1)
Balance at end of the period – business exposures	1,493	82	8	1	1,584
Off-balance sheet credit commitments – business exposures					
Balance at beginning of the period	388	15	-	-	403
Net transfers between stages	(2)	1	-	1	-
Additions	427	3	-	-	430
Deletions	(219)	(5)	-	-	(224)
Off-balance sheet credit commitments at end of the period – business exposures	594	14	-	1	609

Significant changes in the gross carrying amount of business exposures that contributed to changes in the provision for credit impairment for the year ended 30 June 2020 are outlined below.

Credit impairment provisions on business exposures increased by $13m:

- increase in ECL due to net growth in exposures (+$6m),
- changes to economic scenarios (+$1m),
- an increase in management overlays for the credit deterioration expected following the impact of COVID-19 (+$6m).

Notes to the financial statements continued

10. Asset quality continued

Prior period movement in provision for credit impairment – total exposures

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Total provision for loans and commitments at beginning of the period – total exposures	19	14	4	3	40
Transfers between stages:					
- Transferred to Stage 1	3	(3)	-	-	-
- Transferred to Stage 2	-	1	(1)	-	-
- Transferred to Stage 3	-	-	-	-	-
- Transferred to Stage 3 individually assessed	-	-	-	-	-
Total transfers between stages	3	(2)	(1)	-	-
(Credited)/charged to income statement for collectively assessed provisions					
- Net remeasurement of loss allowances	(3)	5	2	-	4
- Changes due to additions and deletions	6	3	2	-	11
- Changes due to amounts written off	-	(2)	-	-	(2)
- Other changes	31	3	-	-	34
Total (credited)/charged to income statement for collectively assessed provisions	34	9	4	-	47
Charged/(credited) to income statement for individually assessed provisions					
- New and increased provisions	-	-	-	1	1
- Write-back of provisions no longer required	-	-	-	-	-
Total charged/(credited) to income statement for individually assessed provisions	-	-	-	1	1
Amounts written off from individually assessed provisions	-	-	-	(2)	(2)
Total provision for loans and commitments at end of the period – total exposures	56	21	7	2	86
Presented as:					
- Provision for credit impairment on loans	51	18	7	2	78
- Provision for credit impairment on undrawn commitments	5	3	-	-	8
Total provision for loans and commitments at end of the period – total exposures	56	21	7	2	86

Notes to the financial statements continued

10. Asset quality continued

Prior period impact of changes in gross carrying amount and credit commitments on ECL – total exposures

	Year ended 30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Gross carrying amount – total exposures					
Balance at beginning of the period	19,676	781	21	5	20,483
Net transfers between stages	(50)	41	9	-	-
Additions	5,694	204	9	1	5,908
Deletions	(3,882)	(178)	(12)	(2)	(4,074)
Amounts written off	-	(7)	-	(2)	(9)
Balance at end of the period – total exposures	21,438	841	27	2	22,308
Off-balance sheet credit commitments – total exposures					
Balance at beginning of the period	3,341	68	-	-	3,409
Net transfers between stages	(13)	10	2	1	-
Additions	1,441	32	-	-	1,473
Deletions	(1,019)	(34)	(2)	-	(1,055)
Off-balance sheet credit commitments at end of the period – total exposures	3,750	76	-	1	3,827

Credit quality of financial assets neither past due nor impaired

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

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

Credit quality of other financial assets

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

Credit risk-related adjustments to financial assets at fair value

Credit impairment losses of $0.1m were recognised through other comprehensive income in relation to expected credit losses on Investment Securities held at fair value through other comprehensive income in the year ended 30 June 2021 (30 June 2020: ($0.1m)).

Credit Valuation Adjustments ("**CVA**") and Debit Valuation Adjustments ("**DVA**") are included in the valuations of Derivative Financial Instruments and these adjustments are recognised within net gains on financial instruments in the income statement. A total of $0.5m was recognised in the income statement related to CVA and DVA during the year ended 30 June 2021 (30 June 2020: $0.4m).

Definitions

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

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

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

Notes to the financial statements continued

11. Concentration of credit risk

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

	30/06/21			30/06/20		
Dollars in millions	On-balance sheet financial assets	Off-balance sheet commitment	Total credit exposure	On-balance sheet financial assets	Off-balance sheet commitment	Total credit exposure
New Zealand						
Agriculture	**16**	**21**	**37**	16	4	20
Food and other manufacturing	**319**	**78**	**397**	164	44	208
Electricity, gas and water	**17**	**4**	**21**	4	8	12
Construction	**520**	**366**	**886**	324	240	564
Retail and wholesale trade	**236**	**84**	**320**	206	47	253
Transport and storage	**238**	**27**	**265**	137	13	150
Communications	**38**	**21**	**59**	21	9	30
Finance, investment and insurance	**570**	**65**	**635**	698	33	731
Property and business services	**1,885**	**199**	**2,084**	1,399	144	1,543
Professional, scientific and technical services	**81**	**25**	**106**	78	26	104
Government, local authorities and services	**1,472**	**1**	**1,473**	1,409	1	1,410
Education	**16**	**3**	**19**	16	3	19
Personal and other services	**106**	**26**	**132**	99	22	121
Health and community services	**147**	**23**	**170**	123	29	152
Households	**21,578**	**3,370**	**24,948**	19,693	3,195	22,888
Overseas						
Finance, investment and insurance	**772**	**8**	**780**	924	9	933
Total credit exposure	**28,011**	**4,321**	**32,332**	25,311	3,827	29,138
Less provision for credit impairment[1]	**(54)**	**(8)**	**(62)**	(78)	(8)	(86)
Other financial assets	**30**	**-**	**30**	27	-	27
Total financial assets	**27,987**	**4,313**	**32,300**	25,260	3,819	29,079

[1]In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, $8m of the total provision for credit impairment as at 30 June 2020 has been moved to the off-balance sheet commitments.

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

Notes to the financial statements continued

11. Concentration of credit risk continued

Maximum exposure to credit risk

Dollars in millions	30/06/21 On-balance sheet financial assets	Off-balance sheet commitments	Maximum exposure to credit risk
Credit risk exposure			
Loans and advances	**25,261**	**4,321**	**29,582**
Due from other financial institutions	**26**	**-**	**26**
Due from related parties	**77**	**-**	**77**
Derivative financial instruments	**228**	**-**	**228**
Investment securities	**1,704**	**-**	**1,704**
Cash and cash equivalents	**715**	**-**	**715**
Other financial assets	**30**	**-**	**30**
Subtotal	**28,041**	**4,321**	**32,362**
Less provision for credit impairment	**(54)**	**(8)**	**(62)**
Total	**27,987**	**4,313**	**32,300**

The table above represents the maximum net credit risk exposure of the Banking Group at 30 June 2021. The exposures set out are based on net carrying amounts as reported in the balance sheet.

The exposure of the Banking Group derived from loans and advances to retail and corporate customers is 90% of the total maximum exposure (30 June 2020: 88%).

Dollars in millions	30/06/20 On-balance sheet financial assets	Off-balance sheet commitments	Maximum exposure to credit risk
Credit risk exposure			
Loans and advances	22,308	3,827	26,135
Due from other financial institutions	105	-	105
Due from related parties	77	-	77
Derivative financial instruments	434	-	434
Investment securities	1,895	-	1,895
Cash and cash equivalents	492	-	492
Other financial assets	27	-	27
Subtotal	25,338	3,827	29,165
Less provision for credit impairment	(78)	(8)	(86)
Total	25,260	3,819	29,079

Collateral management

The Banking Group holds financial charges over borrowers' specific assets and is able to enforce the collateral in satisfying the debt in the event borrowers' fail to meet contractual obligations. The collateral held for mitigating credit risk for the Banking Group's lending portfolios is outlined below.

Retail unsecured lending

Retail unsecured lending includes credit cards and overdrafts, and is an unsecured portfolio. As at 30 June 2021, 100% of the maximum credit exposure is unsecured (30 June 2020: 100% unsecured).

Residential mortgage loans

Residential mortgages are secured by a charge over borrowers' residential property. Additional security can also include a charge over deposits and guarantees from borrowers' related parties. As at 30 June 2021, 98.8% is fully secured and 1.2% is partially secured (30 June 2020: 98.9% is fully secured and 1.1% is partially secured).

Notes to the financial statements continued

11. Concentration of credit risk continued

Business exposures

Business lending is typically secured by way of a charge over property; a charge over business assets, other assets or deposits; or guarantees from borrowers' related parties. Fully secured exposures are those that have security cover greater than or equal to 100%, partially secured exposures are those that have security cover of 40 - 99.9% and unsecured exposures are those that have security cover less than 40%.

As at 30 June 2021, 62.0% is fully secured, 14.0% is partially secured and 24.0% is unsecured (30 June 2020: 64.9% is fully secured, 13.4% is partially secured and 21.7% is unsecured).

Collateral on credit impaired assets

As at 30 June 2021, 69.5% of the Banking Group's impaired gross loans were fully secured, 0.9% were partially secured and 29.6% were unsecured (30 June 2020: 71.8% fully secured, 3.9% partially secured and 24.3% unsecured).

12. Concentration of credit exposures to counterparties

CREDIT EXPOSURE TO INDIVIDUAL COUNTERPARTIES

Credit exposure concentrations to individual counterparties at the reporting date are disclosed on the basis of actual credit exposures. Peak end-of-day aggregate credit exposures are calculated on the basis of the maximum end-of-day aggregate amount of actual credit exposures over the six-month period (gross of set-offs) divided by the Banking Group's common equity tier 1 capital ("**CET1 capital**") at the end of the reporting period.

The individual counterparty exposures included in the following table exclude exposures to:

- connected persons;
- the central government or central bank of any country with a long-term credit rating of A- or A3 or above, or its equivalent; and
- any supranational or quasi-sovereign agency with a long-term credit rating of A- or A3 or above, or its equivalent.

	As at 30/06/21	Peak end-of-day for the 6 months ended 30/06/21
Exposures to banks		
Total number of exposures to banks that are greater than 10% of CET1 capital	-	-
With a long-term credit rating of A- or A3 or above, or its equivalent	-	-
- 10% to less than 15% of CET1 capital	-	-
- 15% to less than 20% of CET1 capital	-	-
- 20% to less than 25% of CET1 capital	-	-
- 25% to less than 30% of CET1 capital	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-
Exposures to non-banks		
Total number of exposures to non-banks that are greater than 10% of CET1 capital	-	-
With a long-term credit rating of A- or A3 or above, or its equivalent	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-

CREDIT EXPOSURES TO CONNECTED PERSONS

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

The Banking Group does not have credit exposures to connected persons other than non-bank connected persons. Peak end-of-day credit exposures to non-bank connected persons have been calculated on the basis of the maximum end-of-day aggregate amount of actual credit exposures over the six-month period (gross of set-offs) divided by the Banking Group's Tier 1 capital at the end of the reporting period. The rating-contingent limit, which is applicable to the Banking Group as at the reporting date, is 60%. There have been no rating-contingent limit changes during the past year. Within the rating-contingent limit there is a sub-limit of 15% of the Banking Group's Tier 1 capital, which applies to non-bank connected persons.

Notes to the financial statements continued

12. Concentration of credit exposures to counterparties

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

There are no individual impairment credit allowances against credit exposures to non-bank connected persons nor are there any contingent exposures arising from risk lay-off arrangements to connected persons as at 30 June 2021 (30 June 2020: nil).

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Credit exposures to non-bank connected persons at year-end	**77**	77
Credit exposures to non-bank connected persons at year-end as a percentage of Tier 1 capital	**4.3%**	4.6%
Peak credit exposures to non-bank connected persons during the year	**94**	97
Peak credit exposures to non-bank connected persons during the year as a percentage of Tier 1 capital	**5.3%**	5.8%

13. Cash and cash equivalents

Accounting policy

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

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

Dollars in millions	**30/06/21**	30/06/20
Cash in hand	**51**	62
Cash with central bank	**579**	360
Call and overnight advances to financial institutions	**85**	70
Total cash and cash equivalents – current	**715**	492

14. Due from other financial institutions

Accounting policy

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

Reverse repurchase agreements

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

Dollars in millions	**30/06/21**	30/06/20
Collateral paid	**26**	105
Total amounts due from other financial institutions – current	**26**	105

Included within the above balance is $25.5m of collateral pledged by Kiwibank in respect of its credit support annex obligations to derivative counterparties (2020: $105.0m).

Notes to the financial statements continued

15. Investment securities

Accounting policy

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

The accounting policy for the calculation of ECL is outlined in Note 9 Credit impairment losses.

Dollars in millions	30/06/21	30/06/20
Government stock and multilateral development banks	**1,295**	1,301
Treasury bills	**-**	75
Local authority securities	**87**	95
Other debt securities	**322**	424
Total investment securities – current	**1,704**	1,895

The fair value of investment securities pledged under repurchase agreements is $111m for the year ended 30 June 2021 (30 June 2020: $202m).

16. Derivative financial instruments and hedging activities

Accounting policy

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

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

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

The Banking Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Banking Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

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

Fair value hedge

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

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

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

Accounting policy continued

Cash flow hedge

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

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

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

Derivatives held for trading

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

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

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

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

Dollars in millions	30/06/21			30/06/20		
	Notional principal amount	Fair values		Notional principal amount	Fair values	
		Assets	Liabilities		Assets	Liabilities
Derivatives held for trading						
Foreign exchange derivatives	**628**	**7**	**(5)**	587	6	(7)
Interest rate derivatives	**7,845**	**144**	**(145)**	12,150	257	(257)
Total derivatives held for trading	**8,473**	**151**	**(150)**	12,737	263	(264)
Derivatives held for hedging						
Designated as cash flow hedges						
Interest rate derivatives	**9,928**	**51**	**(27)**	10,366	55	(132)
Exchange rate derivatives	**1,266**	**25**	**(11)**	836	109	(4)
Total derivatives designated as cash flow hedges	**11,194**	**76**	**(38)**	11,202	164	(136)
Designated as fair value hedges						
Interest rate derivatives	**400**	**1**	**(7)**	200	7	-
Total derivatives designated as fair value hedges	**400**	**1**	**(7)**	200	7	-
Total derivatives held for hedging	**11,594**	**77**	**(45)**	11,402	171	(136)
Total derivative financial instruments	**20,067**	**228**	**(195)**	24,139	434	(400)
Current		**23**	**(34)**		78	(81)
Non-current		**205**	**(161)**		356	(319)

DERIVATIVES HELD FOR HEDGING

Interest rate derivatives

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

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

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

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

Hedge accounting strategies:

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

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

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

Interest and foreign exchange derivatives

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

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

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

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

Ineffectiveness arises from the following sources:

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

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

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

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

	30/06/21				
Dollars in millions	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Total
Interest rate risk					
Cash flow hedge relationships					
Pay fixed					
Interest rate swaps					
Nominal amounts	**1,012**	**3,655**	**3,937**	**-**	**8,604**
Average interest rate	**1.14%**	**0.76%**	**0.61%**	**-**	
Receive fixed					
Interest rate swaps					
Nominal amounts	**-**	**309**	**1,015**	**-**	**1,324**
Average interest rate	**-**	**1.33%**	**1.67%**	**-**	
Fair value hedge relationships					
Pay fixed					
Interest rate swaps					
Nominal amounts	**-**	**-**	**-**	**-**	**-**
Average interest rate	**-**	**-**	**-**	**-**	
Receive fixed					
Interest rate swaps					
Nominal amounts	**-**	**-**	**400**	**-**	**400**
Average interest rate	**-**	**-**	**0.76%**	**-**	
Total interest rate risk nominal amounts	**1,012**	**3,964**	**5,352**	**-**	**10,328**
Interest rate and foreign exchange risk					
Cash flow hedge relationships					
Cross-currency swaps (HKD: NZD)					
Nominal amounts	**-**	**100**	**-**	**-**	**100**
Average HKD–NZD exchange rate	**-**	**5.49**	**-**	**-**	
Average interest rate	**-**	**float**	**-**	**-**	
Cross-currency swaps (AUD: NZD)					
Nominal amounts	**-**	**-**	**538**	**-**	**538**
Average AUD–NZD exchange rate	**-**	**-**	**0.92**	**-**	
Average interest rate	**-**	**-**	**float**	**-**	
Fair value and cash flow hedge relationships					
Cross-currency swaps (HKD: NZD)					
Nominal amounts	**-**	**-**	**203**	**-**	**203**
Average HKD–NZD exchange rate	**-**	**-**	**5.58**	**-**	
Average interest rate	**-**	**-**	**1.30%**	**-**	
Cross-currency swaps (CHF: NZD)					
Nominal amounts	**-**	**-**	**233**	**-**	**233**
Average CHF–NZD exchange rate	**-**	**-**	**0.69**	**-**	
Average interest rate	**-**	**-**	**0.26%**	**-**	
Cross-currency swaps (AUD: NZD)					
Nominal amounts	**-**	**-**	**31**	**161**	**192**
Average AUD–NZD exchange rate	**-**	**-**	**0.78**	**0.89**	
Average interest rate	**-**	**-**	**5.52%**	**4.25%**	
Total interest rate and foreign exchange risk nominal amounts	**-**	**100**	**1,005**	**161**	**1,266**
Total nominal amounts	**1,012**	**4,064**	**6,357**	**161**	**11,594**

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

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

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

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

	30/06/21		Year ended 30/06/21
Dollars in millions	Carrying value	Accumulated amount of fair value hedge adjustments	Gains/(losses) on fair value attributable to hedged risk used for recognising hedge ineffectiveness
Interest rate risk			
Subordinated debt	**(193)**	**7**	**7**
Debt securities issued	**(200)**	**-**	**7**
Total	**(393)**	**7**	**14**
Interest rate swaps	**(6)**	**(7)**	**(14)**
Interest rate risk and foreign currency risk			
Debt securities issued	**(647)**	**(19)**	**19**
Cross-currency swaps	**14**	**18**	**(19)**
Total ineffectiveness of financial instruments in fair value hedge relationship			**-**

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

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for any hedged items that have ceased to be adjusted for hedging gains and losses is $nil (30 June 2020: $nil).

Notes to the financial statements continued

16. Derivative financial instruments and hedging activities continued

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

		Interest rate risk	Interest and foreign currency risk	
Dollars in millions		Interest rate swaps	Cross-currency swaps	Total
As at 30/06/21				
Notional amount		**9,928**	**1,266**	**11,194**
Carrying amount:				
Assets		**51**	**25**	**76**
Liabilities		**(27)**	**(11)**	**(38)**
Changes in fair value of hedging instruments used for measuring hedge ineffectiveness:				
Hedged item		**(84)**	**82**	**(2)**
Hedging instrument		**84**	**(82)**	**2**
Year ended 30/06/21	**Recognised in/ reclassified to:**			
Effective portion	OCI[1]	**12**	**(3)**	**9**
Hedge ineffectiveness	Net gains on FI[2]	**-**	**-**	**-**
Reclassified into income statement as:	Interest (expense)/income	**(72)**	**(6)**	**(78)**
	Net gains on FI[2]	**-**	**85**	**85**

[1] Other comprehensive income

[2] Net gains on financial instruments

		Interest rate risk	Interest and foreign currency risk	
Dollars in millions		Interest rate swaps	Cross-currency swaps	Total
As at 30/06/20				
Notional amount		10,366	836	11,202
Carrying amount:				
Assets		55	109	164
Liabilities		(132)	(4)	(136)
Changes in fair value of hedging instruments used for measuring hedge ineffectiveness:				
Hedged item		52	(68)	(16)
Hedging instrument		(52)	68	16
Year ended 30/06/20	**Recognised in / reclassified to:**			
Effective portion	OCI[1]	(65)	(8)	(73)
Hedge ineffectiveness	Net gains on FI[2]	-	-	-
Reclassified into income statement as:	Interest (expense)/income	(32)	(11)	(43)
	Net gains on FI[2]	-	39	39

[1] Other comprehensive income

[2] Net gains on financial instruments

Notes to the financial statements continued

17. Due to other financial institutions

Accounting policy

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

Repurchase agreements

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

Dollars in millions	**30/06/21**	30/06/20
Cash collateral received	**26**	105
Transaction balances with other financial institutions	**7**	10
Repurchase agreements	**685**	202
Total amounts due to other financial institutions	**718**	317
Current	**145**	317
Non-current	**573**	-

Funding for lending programme

On 11 November 2020, the RBNZ announced a Funding for Lending Programme ("**FLP**") as one of the tools to 'maintain low and stable inflation and support full employment'. The FLP allows the Bank to borrow directly from the RBNZ at the floating Official Cash Rate ("**OCR**") for a term of three years and is effective from 7 December 2020 to 6 December 2022. A total of $602.9m of residentially mortgage-backed security ("**RMBS**") has been pledged as approved eligible collateral.

The Bank's initial allocation, being 4% of eligible loans as at 31 October 2020, able to be drawn down between 7 December 2020 and 6 June 2022 is $924m. An additional allocation may be drawn down equal to $0.50 for every dollar of net growth in eligible loans from 1 November 2020 up to a maximum of 2% of eligible loans as at 31 October 2020. The additional allocation can be drawn down until 6 December 2022. The current OCR rate is 0.25%, and this rate will adjust in line with changes in the OCR over the lending term. As at 30 June 2021, $500m had been drawn down (30 June 2020: $nil).

Term lending facility

On 26 May 2020, the RBNZ established a Term Lending Facility ("**TLF**") to support the functioning of the Business Finance Guarantee Scheme (BFGS), with financing under the TLF tied to the utilisation of the BFGS. Under the TLF, each eligible counterparty in the BFGS can draw down an amount equivalent to the outstanding BFGS amount for that participant.

The minimum request size under the TLF was $1m cash at a rate of the OCR, fixed for up to five years. The facility required $87m of RMBS-backed security to be pledged as approved eligible collateral. The BFGS ended on 30 June 2021 and the the TLF will be available until 28 July 2021. As at 30 June 2021, $73m had been drawn down (30 June 2020: nil).

18. Deposits and other borrowings

Accounting policy

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

18. Deposits and other borrowings continued

Dollars in millions	30/06/21	30/06/20[1]
Demand deposits non-interest bearing	**4,576**	3,353
Demand deposits bearing interest	**6,075**	4,709
Term deposits	**11,748**	12,535
Total deposits and other borrowings	**22,399**	20,597
Current	**22,086**	20,197
Non-current	**313**	400

[1] A wholesale call account balance as at 30 June 2020 of $243m has been restated from 'Term deposits' to 'Demand deposits bearing interest' to align with the classification in the current period.

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

The Kiwibank PIE Unit Trust (the "**Trust**"), established in May 2008, operates three funds: the PIE Term Deposit Fund, the Notice Fund and PIE Online Call Fund. Kiwibank Investment Management Limited is the issuer and manager (the "**Manager**"), Trustees Executors Limited is the Supervisor and Kiwibank is the promoter of the Trust. Units in the Trust do not directly represent deposits or liabilities of Kiwibank; however, the Trust is invested exclusively in term and call deposits with Kiwibank. As at 30 June 2021, $4,436m of the Trust's funds were invested in Kiwibank products or securities (30 June 2020: $4,707m).

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

19. Debt securities issued

Accounting policy

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

Dollars in millions	30/06/21	30/06/20
Short-term debt		
Certificates of deposit	**419**	479
Long-term debt		
Medium-term notes	**1,570**	1,460
Covered bonds	**536**	246
Fair value hedge adjustment	**19**	44
Total debt securities issued	**2,544**	2,229
Current	**730**	769
Non-current	**1,814**	1,460

Notes to the financial statements continued

19. Debt securities issued continued

Reconciliation of movement in liability arising from financing activities

Dollars in millions	30/06/21	30/06/20
Opening balance	**2,229**	2,078
Issuances	**1,456**	1,627
Repayments	**(1,093)**	(1,537)
Total cash movements	**363**	90
Effect of changes in foreign exchange rates	**(24)**	43
Fair value and other movements	**(24)**	18
Closing balance	**2,544**	2,229

The Banking Group redeemed $240m (CHF150m) of covered bonds upon maturity during the year ended 30 June 2021 (30 June 2020: $nil). The Banking Group also issued $541m (AUD500m) of covered bonds during the year ended 30 June 2021 (30 June 2020: $nil).

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

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

Kiwibank has not had any defaults of principal, interest or other breaches with respect to debt securities issued during the year ended 30 June 2021 (30 June 2020: nil).

20. Subordinated debt

Accounting policy

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

Dollars in millions	30/06/21	30/06/20
Perpetual capital bonds	**150**	150
Subordinated notes	**265**	-
Total subordinated debt	**415**	150
Current	**-**	-
Non-current	**415**	150

The Banking Group issued $275m of subordinated notes during the year ended 30 June 2021 (30 June 2020: $nil). The Banking Group has not repaid any subordinated debt during the year ended 30 June 2021 (30 June 2020: $100m).

The Banking Group has not had any defaults of principal, interest or other breaches with respect to these liabilities during the year (year ended 30 June 2020: nil).

As at 30 June 2021, $194m of the $275m subordinated debt qualified as Tier 2 capital for Capital Adequacy calculation purposes (30 June 2020: $nil). As at 30 June 2021, $150m of subordinated debt qualified as Additional Tier 1 capital for Capital Adequacy calculation purposes (30 June 2020: $150m). The contractual terms of subordinated debt instruments on issue expressly stipulate that they do not have the benefit of a deed poll guarantee (the "**NZP Guarantee**") provided by NZP. The NZP Guarantee was terminated with an effective date of 28 February 2017.

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

Notes to the financial statements continued

20. Subordinated debt continued

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

Instrument	Issue date	Amount ($m)	Coupon rate	Next reset date	Maturity date
Perpetual capital bonds	27 May 2015	150	3.985% p.a.[1]	27 May 2025	None
Subordinated notes	11 December 2020	275	2.36% p.a.[2]	11 December 2025	11 December 2030

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

[2] Fixed interest rate which will be reset on 11 December 2025.

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

Perpetual Capital Bonds – Regulatory Event

On 17 June 2021, the RBNZ published new Banking Prudential Requirements which will come into effect from 1 October 2021. The Banking Group's conditions of registration are expected to be amended from 1 October 2021 to give effect to these changes. As a result of the amendment to the conditions of registration, a Regulatory Event will occur in respect of the perpetual capital bonds due to a 12.5% reduction in the capital recognition from 1 January 2022 and 100% derecognition over time. The occurrence of the Regulatory Event will entitle Kiwibank to exercise an option to redeem the bonds, subject to certain conditions including RBNZ consent. No decision has been made as to whether the perpetual capital bonds will be repaid following the Regulatory Event.

Reconciliation of movement in liability arising from financing activities

Dollars in millions	30/06/21	30/06/20
Opening balance	**150**	253
Issuances net of issuance costs	**272**	-
Repayments	**-**	(100)
Interest paid	**(3)**	(3)
Total cash movements	**269**	(103)
Interest accrued	**3**	-
Fair value hedge adjustment and other movements	**(7)**	-
Closing balance	**415**	150

Notes to the financial statements continued

21. Concentration of funding

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

Dollars in millions	30/06/21	30/06/20
New Zealand		
Agriculture	**56**	41
Food and other manufacturing	**244**	302
Electricity, gas and water	**18**	20
Construction	**309**	284
Retail and wholesale trade	**268**	151
Transport and storage	**142**	60
Communications	**41**	33
Finance, investment and insurance	**4,531**	3,603
Property and business services	**351**	300
Professional, scientific and technical services	**272**	258
Government, local authorities and services	**365**	219
Education	**216**	227
Personal and other services	**240**	233
Health and community services	**318**	235
Households	**17,271**	16,329
Overseas		
Finance, investment and insurance	**1,267**	1,055
Households	**302**	342
Other	**66**	8
Total funding	**26,277**	23,700
Lease liabilities	**119**	97
Other financial liabilities	**43**	70
Total financial liabilities	**26,439**	23,867

Notes to the financial statements continued

22. Financial instruments

Accounting policy

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

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

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

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

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

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

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

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

a) Measurement basis of financial assets and liabilities

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

	30/06/21					
Dollars in millions	Amortised cost	FVOCI	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	Total
Cash and cash equivalents	**715**	-	-	-	-	**715**
Due from other financial institutions	**26**	-	-	-	-	**26**
Investment securities	-	**1,704**	-	-	-	**1,704**
Loans and advances	**25,207**	-	-	-	-	**25,207**
Derivative financial instruments	-	-	**151**	-	**77**	**228**
Due from related parties	**77**	-	-	-	-	**77**
Other financial assets	**28**	-	-	**2**	-	**30**
Total financial assets	**26,053**	**1,704**	**151**	**2**	**77**	**27,987**

Notes to the financial statements continued

22. Financial instruments continued

Dollars in millions	Amortised cost	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	Total
	30/06/21				
Due to other financial institutions	**718**	**-**	**-**	**-**	**718**
Deposits and other borrowings	**22,399**	**-**	**-**	**-**	**22,399**
Derivative financial instruments	**-**	**150**	**-**	**45**	**195**
Debt securities issued	**2,544**	**-**	**-**	**-**	**2,544**
Subordinated debt	**415**	**-**	**-**	**-**	**415**
Due to related parties	**6**	**-**	**-**	**-**	**6**
Lease liabilities	**119**	**-**	**-**	**-**	**119**
Other financial liabilities	**43**	**-**	**-**	**-**	**43**
Total financial liabilities	**26,244**	**150**	**-**	**45**	**26,439**

Dollars in millions	Amortised cost	FVOCI	Mandatorily at FVTPL	Designated at FVTPL	Derivatives used for hedging at FVTPL	Total
	30/06/20					
Cash and cash equivalents	492	-	-	-	-	492
Due from other financial institutions	105	-	-	-	-	105
Investment securities	-	1,895	-	-	-	1,895
Loans and advances[1]	22,230	-	-	-	-	22,230
Derivative financial instruments	-	-	263	-	171	434
Due from related parties	77	-	-	-	-	77
Other financial assets	25	-	-	2	-	27
Total financial assets	22,929	1,895	263	2	171	25,260

[1]In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, $8m of the total provision for credit impairment as at 30 June 2020 has been moved to the off-balance sheet commitments.

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

Notes to the financial statements continued

22. Financial instruments continued

b) Fair values of financial assets and liabilities

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

	30/06/21		30/06/20[1]	
Dollars in millions	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets				
Investment securities	**1,704**	**1,704**	1,895	1,895
Loans and advances	**25,207**	**25,182**	22,230	22,313
Derivative financial instruments	**228**	**228**	434	434
Due from related parties	**77**	**77**	77	77
Financial liabilities				
Deposits and other borrowings	**22,399**	**22,411**	20,597	20,628
Derivative financial instruments	**195**	**195**	400	400
Debt securities issued	**2,544**	**2,570**	2,229	2,239
Subordinated debt	**415**	**427**	150	154
Due to related parties	**6**	**6**	7	7

[1] In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have been increased by $8m.

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

c) Fair value measurement

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

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

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

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

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

There have been no transfers between levels 1 and 2 during the year (year ended 30 June 2020: no transfers). There were also no transfers into/out of level 3 during the year (year ended 30 June 2020: no transfers).

22. Financial instruments continued

d) Financial assets and liabilities carried at fair value

Valuation methodology

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

Investment securities

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

Derivative financial instruments

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

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

	30/06/21				30/06/20			
Dollars in millions	**Level 1**	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
Financial assets at fair value								
Derivative financial assets	**-**	**228**	**-**	**228**	-	434	-	434
Investment securities	**690**	**1,014**	**-**	**1,704**	792	1,103	-	1,895
Other financial assets	**-**	**-**	**2**	**2**	-	-	2	2
Financial liabilities at fair value								
Derivative financial liabilities	**-**	**195**	**-**	**195**	-	400	-	400

e) Financial assets and liabilities carried at amortised cost

Valuation methodology

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

Loans and advances

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

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

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

Impaired and past due loans and advances

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

Deposits by customers

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

22. Financial instruments continued

Debt securities issued and subordinated debt

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

	30/06/21				30/06/20			
Dollars in millions	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets at amortised cost								
Loans and advances	-	-	25,182	25,182	-	-	22,313	22,313
Due from related parties	-	-	77	77	-	-	77	77
Financial liabilities at amortised cost								
Deposits and other borrowings	-	-	22,411	22,411	-	-	20,628	20,628
Debt securities issued	-	2,570	-	2,570	-	2,239	-	2,239
Subordinated debt	-	427	-	427	-	154	-	154
Due to related parties	-	-	6	6	-	-	7	7

23. Offsetting financial assets and liabilities

Accounting policy

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

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

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

		30/06/21					
					Related amounts not set off in the balance sheet		
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Financial instruments	Cash collateral received	Net amount
Derivative financial assets	16	228	-	228	(165)	26	89
Total		228	-	228	(165)	26	89
					Related amounts not set off in the balance sheet		
		Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Financial instruments	Cash collateral pledged	Net amount
Derivative financial liabilities	16	195	-	195	(165)	(26)	4
Repurchase agreements[1]	17	685	-	685	(685)	-	-
Total		880	-	880	(850)	(26)	4

[1] $111m of investments securities and $691m of residentially mortgage-backed securities have been pledged as collateral under a collateralised borrowing arrangement (repurchase agreements). Refer to Note 15 and Note 17 for further details.

Notes to the financial statements continued

23. Offsetting financial assets and liabilities continued

		30/06/20					
					Related amounts not set off in the balance sheet		
Dollars in millions	Note	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amounts of financial assets presented in the balance sheet	Financial instruments	Cash collateral received	Net amount
Derivative financial assets	16	434	-	434	(293)	(105)	36
Total		434	-	434	(293)	(105)	36
					Related amounts not set off in the balance sheet		
		Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amounts of financial liabilities presented in the balance sheet	Financial instruments	Cash collateral pledged	Net amount
Derivative financial liabilities	16	400	-	400	(293)	(105)	2
Repurchase agreements	17	202	-	202	(202)[1]	-	-
Total		602	-	602	(495)	(105)	2

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

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

24. Transfer of financial assets

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

Kiwibank RMBS Trust Series 2009-1 (the "RMBS Trust")

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

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

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

The carrying value and fair value of the RMBS pool at 30 June 2021 is $3,500m (30 June 2020: $1,350m). These securities are ring-fenced to ensure they are not used as collateral outside of agreements established with the RMBS Trust.

Notes to the financial statements continued

24. Transfer of financial assets continued

Kiwi Covered Bond Trust (the "Covered Bond Trust")

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

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

The carrying value and approximate fair value of the Covered Bond Trust pool at 30 June 2021 is $700m (30 June 2020: $316m). These securities are ring-fenced to ensure they are not used as collateral outside of agreements established with the Covered Bond Trust.

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

Repurchase agreements

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

As at 30 June 2021, the Banking Group has recognised liabilities for an outstanding repurchase agreement of $685m (30 June 2020: $202m).

Funding for lending programme and Term lending facility

The Banking Group has entered into an agreement with the RBNZ to draw down funds under the Funding for lending programme and Term lending facility. RMBS-backed securities have been pledged as approved eligible collateral. Refer to Note 17 'Due to other financial institutions' for details of the agreements.

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

As at 30 June 2021, the Banking Group has not derecognised any financial assets where they have a continuing involvement (30 June 2020: $nil).

25. Intangible assets

Accounting policy

Internally developed software assets expected to generate net economic benefits beyond 12 months are recognised as intangible assets. The cost of software assets primarily includes the cost of all direct labour on the project, and an appropriate proportion of variable and fixed overheads. Software intangible assets are amortised over their estimated useful lives (primarily 3 to 7 years).

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

25. Intangible assets continued

Critical accounting estimates and judgements

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

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

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

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

Annual impairment testing

During the year ended 30 June 2021, the Banking Group brought forward annual impairment testing to be completed in May 2021 using key inputs as at 30 April 2021. Annual impairment testing will be performed using inputs as at 30 April each year. The recoverable amount of the Banking Group's CGU was estimated using the fair value less cost of disposal ("**FVLCOD**") expected to be realised in the sale of the Bank. The methodologies used by the Bank contain unobservable inputs, and are considered level 3 in the fair value hierarchy. The Bank considered the FVLCOD under a number of accepted methodologies and determined that, at this time, the capitalisation of net tangible assets ("**NTA**") and capitalisation of earnings to be the most appropriate and aligned with the methodology applied during the year ended 30 June 2020.

Kiwibank did not identify any evidence of impairment for the year ended 30 June 2021. However, as Kiwibank holds intangible assets that are not yet available for use an annual impairment test has been performed. The Bank has assessed for any indicators of impairment occuring between the assessment date of 30 April 2021 through to the reporting date of 30 June 2021.

The key inputs and assumptions in determining the recoverable amounts under these methods were the Banking Group's reported net tangible assets at 30 April 2021, expectations of the CGU's future maintainable earnings ("**FME**") and observable market trading and transaction multiples seen in recent transactions of similar entities (referencing industry, geography, transaction size and control premium/discounts).

Key inputs and results	30/06/2021	30/06/2020
NTA multiple	**1.25x NTA**	1.35x NTA
FME multiple	**13x FME**	12x FME
Result	**CGU carrying amount did not exceed the recoverable amount**	CGU carrying amount did not exceed the recoverable amount
Conclusion	**No impairment of non-financial assets was recognised.**	No impairment of non-financial assets was recognised.

A reasonably possible change in assumptions does not result in impairment (30 June 2020: An assessed value at 1.0x NTA or 11.1x FME would result in an impairment. This was not considered a reasonably possible outcome.).

Notes to the financial statements continued

25. Intangible assets continued

	30/06/21			30/06/20		
	Internally developed			Internally developed		
Dollars in millions	Computer software	Computer software work in progress	Total	Computer software	Computer software work in progress	Total
Cost at beginning of the year	**262**	**10**	**272**	256	11	267
Accumulated amortisation at beginning of the year	**(212)**	**-**	**(212)**	(193)	-	(193)
Carrying value at beginning of the year	**50**	**10**	**60**	63	11	74
Additions	**-**	**15**	**15**	-	12	12
Transfers from computer software work in progress	**15**	**(15)**	**-**	8	(8)	-
Amortisation	**(25)**	**-**	**(25)**	(22)	-	(22)
Amortisation released on write-off, disposal or retirement	**11**	**-**	**11**	3	-	3
Amounts written off or disposed of	**-**	**-**	**-**	(2)	(5)	(7)
Amounts retired	**(11)**	**-**	**(11)**	-	-	-
Carrying value at end of the year	**40**	**10**	**50**	50	10	60
Cost at end of the year	**266**	**10**	**276**	262	10	272
Accumulated amortisation at end of the year	**(226)**	**-**	**(226)**	(212)	-	(212)
Carrying value at end of the year	**40**	**10**	**50**	50	10	60

26. Other assets

Accounting policy

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

Dollars in millions	30/06/21	30/06/20
Prepayments	**11**	9
Trade and other receivables	**30**	29
Current tax asset	**1**	-
Total other assets	**42**	38
Current	**42**	36
Non-current	**-**	2

27. Other liabilities

Accounting policy

Other liabilities are initially measured at fair value and subsequently at amortised cost using the effective interest method. Amortisation and foreign exchange gains and losses are recognised in the income statement as is any gain or loss when the liability is derecognised.

The Banking Group recognises provisions where there is a present obligation arising from a past event, an outflow of economic resources is probable, and the amount of the provision can be measured reliably. Provisions involve judgements regarding the outcome of future events including estimating the expenditure required to satisfy obligations. The appropriateness of the underlying assumptions is reviewed on a regular basis and adjustments are made to provisions to reflect the most likely outcome.

Where the transaction price for a contract with a customer is received before the Banking Group has satisfied the related performance obligations, a contract liability is recognised. Unsatisfied performance obligations relate to Card services.

Dollars in millions	**30/06/21**	30/06/20
Trade and other payables	**29**	39
Contract liabilities	**7**	10
Current tax liability	**-**	23
Employee entitlements	**32**	22
Provisions	**16**	12
ECL allowance on undrawn commitments[1]	**8**	8
Other liabilities	**17**	37
Total other liabilities – current	**109**	151
Current	**106**	147
Non-current	**3**	4

[1]In the current period, when the provision for credit impairment exceeds the carrying amount of drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation and the requirements of NZ IFRS 7. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have increased by $8m.

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

Movement in provisions

Dollars in millions	Customer remediation	Other	Total
Balance at start of the year	9	3	12
New and increased provisions made during the year	**6**	**8**	**14**
Provisions used during the year	**(6)**	**(2)**	**(8)**
Unused amounts reversed during the year	**(1)**	**(1)**	**(2)**
Balance at end of the year	**8**	**8**	**16**

Customer remediation

Customer remediation provision includes provisions recognised in respect of regulatory and customer remediations for expected refunds or payments to customers and other counterparties where the Banking Group has completed an assessment and reliably estimated the likely loss.

The Bank uncovered issues in relation to the Credit Contracts and Consumer Finance Act 2003 and reported to the Commerce Commission in August 2019 that it failed to have in place robust home loan variation policies, procedures and systems for certain types of home loan variations in the period before April 2019. On 27 August 2020, the Commerce Commission and Kiwibank agreed that Kiwibank would pay $5.2m to customers to settle the issue. All amounts in relation to this matter were provided for in the period to 30 June 2020. As at 30 June 2021, $5.1m has been paid out to affected customers.

Other provisions

Other provisions comprises various other provisions including make good, and restructuring provisions.

28. Leases

Accounting policy

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

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

i) Right-of-use assets

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

The right-of-use assets are also subject to impairment review in line with other non-financial assets as disclosed in Note 25.

ii) Lease liabilities

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

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

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

iii) Lease term

The Banking Group determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease if it is reasonably certain not to be exercised.

iv) Incremental borrowing rate (“IBR”)

Where the Banking Group cannot readily determine the interest rate implicit in the lease, it uses its incremental borrowing rate (“**IBR**”) to discount future payments in measuring lease liabilities. The IBR is the rate of interest that the Banking Group would have to pay to borrow over a similar term, and, with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. The Banking Group estimates the IBR for each lease using observable inputs (such as market interest rates) when available.

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

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

28. Leases continued

Types of lease contracts

The Banking Group has the following lease types:

- Property leases that are either direct leases or subleases. The properties leased by the Banking Group are corporate offices and retail branch sites. Leases of corporate properties have typical lease terms of six to thirty years, inclusive of options to extend. Leases of branch sites have typical lease terms of three to nine years. Some leases provide for adjustments in rent payments for annual fixed percentage increases, market rent reviews, and changes in local price indices. The Banking Group subleases some branch sites where the head lease is held by NZP.
- ATMs generally have lease terms of three years. These leases usually have two rights of renewal of three years resulting in a lease term of nine years.
- Vehicle leases generally have a lease term of three years. These leases do not have an option to extend and are usually replaced at the end of the lease term.
- IT equipment leases generally have a lease term of three to five years. These leases usually have an option to extend or to terminate the lease. The Banking Group has included options to extend within the lease term where it has been assessed as reasonably certain the IT equipment will continue to be utilised after the initial term of the lease expires.

Options to extend

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

Lease commitments

During the year ended 30 June 2021, the Banking Group entered into a material lease for a corporate office in Fanshawe Street, Auckland. The lease commenced on 20 October 2020 and has an initial lease term of 12 years. The lease agreement has two further options to extend of 6 years each. The Banking Group has assessed that it is not reasonably certain that these extensions will be taken up; therefore, no options to extend have been factored into the lease term on initial recognition.

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

i) Right-of-use assets

Dollars in millions	Property	ATM	Vehicle	IT	Total
Balance as at 1 July 2019	80	3	1	-	84
Depreciation charge for the year	(12)	(1)	(1)	-	(14)
Additions	23	1	1	-	25
Balance as at 30 June 2020	91	3	1	-	95
Balance as at 1 July 2020	**91**	**3**	**1**	**-**	**95**
Depreciation charge for the year	**(14)**	**(1)**	**(1)**		**(16)**
Additions	**27**	**-**	**-**	**4**	**31**
Balance as at 30 June 2021	**104**	**2**	**-**	**4**	**110**

As at 30 June 2020, the Banking Group had non-cash additions to right-of-use assets of $20.4m in the financial year that related to the extension of lease terms.

Notes to the financial statements continued

28. Leases continued

ii) Lease liabilities

Dollars in millions	Property	ATM	Vehicle	IT	Total
Balance as at 1 July 2019	80	3	1	-	84
Additions	23	1	1	-	25
Accretion of interest	2	-	-	-	2
Payments	(12)	(1)	(1)	-	(14)
Balance as at 30 June 2020	93	3	1	-	97
Balance as at 1 July 2020	**93**	**3**	**1**	**-**	**97**
Additions	**32**	**-**	**-**	**4**	**36**
Accretion of interest	**3**	**-**	**-**	**-**	**3**
Payments	**(15)**	**(1)**	**(1)**	**-**	**(17)**
Balance as at 30 June 2021	**113**	**2**	**-**	**4**	**119**

Dollars in millions	30/06/21	30/06/20
Current	**14**	12
Non-current	**105**	85
Total lease liabilities included in the balance sheet	**119**	97

iii) Maturity analysis – contractual undiscounted cash flows

Dollars in millions	30/06/21	30/06/20
Less than one year	**17**	15
Between one and five years	**54**	53
Greater than five years	**66**	47
Total lease commitments	**137**	115

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

iv) Amounts recognised in profit or loss

Dollars in millions	30/06/21	30/06/20
Interest expense on lease liabilities	**3**	2
Depreciation on right-of-use assets	**16**	14
Income from subleasing right-of-use assets	**1**	-
Expenses relating to short-term leases	**1**	-

v) Amounts recognised in the cash flow statement

Dollars in millions	30/06/21	30/06/20
Principal payments	**14**	12
Interest expense on lease liabilities	**3**	2
Total cash outflow for leases	**17**	14

Notes to the financial statements continued

29. Equity

Accounting policy

Share capital

i) Ordinary shares

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

ii) Distributions

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

Perpetual capital bonds

i) Discretionary distributions

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

Other reserves

i) Fair value reserve

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

ii) Cash flow hedge reserve

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

ORDINARY SHARES

The total authorised number of ordinary shares in Kiwibank at the reporting date was 737 million (30 June 2020: 737 million). All issued ordinary shares are fully paid. All ordinary shares have equal voting rights and share equally in dividends and surpluses on winding up. Ordinary shares do not have a par value. The whole of the issued ordinary share capital is owned by KGHL, which is incorporated in New Zealand.

Dollars in millions	**30/06/21**	30/06/20
Balance at beginning of the year (2021: 737m shares; 2020: 737m shares)	**737**	737
Issued in year (2021: nil shares; 2020: nil shares)	**-**	-
Balance at end of the year (2021: 737m shares; 2020: 737m shares)	**737**	737

Notes to the financial statements continued

29. Equity continued

RESERVES

Dollars in millions	30/06/21	30/06/20
Balance at beginning of the year	**833**	812
Balance adjusted for adoption of NZ IFRS 16	**-**	1
Net profit for the year	**126**	57
Dividends paid on ordinary shares	**(6)**	(17)
Distributions to holders of perpetual capital	**(6)**	(11)
Net movement in cash flow hedge reserve	**63**	(22)
Net movement in fair value reserve	**(23)**	13
Balance at end of the year	**987**	833

CASH FLOW HEDGING RESERVE

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

Dollars in millions	30/06/21	30/06/20[1]
Balance at beginning of the year	**(44)**	(22)
Gross changes in fair value	**9**	(73)
Tax on changes in fair value	**(2)**	20
Cumulative loss transferred to the income statement	**78**	43
Tax effect of items transferred to income statement	**(22)**	(12)
Balance at end of the year	**19**	(44)

[1] In the current period, the Banking Group has presented movements in the cash flow hedge reserve on a gross basis comprising hedging gains and losses and amounts reclassified from the cash flow hedge reserve into profit or loss. Comparatives have been restated to align with the current year presentation. Accordingly, gross changes in fair value and cumulative loss transferred to the income statement have been restated by $43m.

FAIR VALUE RESERVE

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

Dollars in millions	30/06/21	30/06/20
Balance at beginning of the year	**24**	11
Gross changes in fair value	**(35)**	14
Tax on changes in fair value	**10**	(4)
Cumulative gain transferred to the income statement on disposal of financial assets	**3**	4
Tax effect of items transferred to income statement	**(1)**	(1)
Balance at end of the year	**1**	24

Capital

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

- Tier 1 capital, which comprises Common Equity tier 1 capital and Additional tier 1 capital; and
- Tier 2 capital, which includes subordinated notes (2020: nil).

Common Equity and Additional tier 1 capital comprises ordinary shares, retained earnings, fair value reserve and perpetual capital bonds ("**PCB**") less deductions for intangible assets, deferred tax assets and receivables from an affiliated insurance group.

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

Notes to the financial statements continued

29. Equity continued

Capital management

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

No changes have been made to the objectives, policies and processes from the previous year. However, they are under regular review by the Board.

RBNZ Capital Review

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

- increase in the Common Equity Tier 1 capital ratio required to 11.5%;
- increase in Tier 1 capital ratio required to 14%; and
- increase in the Total Capital ratio required to 16%.

On 5 May 2021, the RBNZ announced that the formal start date for the new reform will be extended from 1 July 2021 to 1 October 2021 and will be implemented in stages over a seven-year transition period. Kiwibank expects to meet the capital requirements through a combination of growth in retained earnings and the issuance of qualifying capital instruments over the transition period.

Dividends

Dollars in millions	**30/06/21**	30/06/20
Declared and paid during the year on ordinary shares:		
0.76 cents per share (2020: 2.26 cents per share)	**(6)**	(17)
Total dividends paid	**(6)**	(17)

Restriction on payment of dividends due to COVID-19

On 2 April 2020, the RBNZ amended the Bank's conditions of registration to restrict the Bank from making distributions of dividends on ordinary shares in line with changes for all locally incorporated banks in New Zealand during the period of economic uncertainty caused by COVID-19. On 31 March 2021, the RBNZ announced the easing of the dividend restrictions allowing banks to pay up to 50% of earnings from the most recently completed financial year as dividends to their shareholders. The 50% dividend restriction will stay in place until 1 July 2022 when the RBNZ intends to remove the restriction entirely (subject to no significant worsening in economic conditions).

The payment of discretionary sums payable to holders of Additional Tier 1 capital instruments is excluded from this restriction.

Discretionary distributions

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

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

These restrictions will apply until:

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

30. Related entities

Accounting policy

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

An SPV is consolidated and reported as part of the Banking Group if it is controlled by the Bank. The definition of control is outlined in Note 2.3.

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

		Interest held by Kiwibank Limited	
Name of entity	Principal activity	**30/06/21**	30/06/20
New Zealand Home Lending Limited	Agency services for mortgage lending through the New Zealand Home Loans Company Limited	**100%**	**100%**
AMP Home Loans Limited	Agency services for mortgage lending through the AMP Advisor network	**n/a**[1]	**100%**
Kiwibank Investment Management Limited	Provision of investment management services	**100%**	**100%**
Kiwi Asset Finance Limited	Asset finance company	**100%**	**100%**
Kiwibank PIE Unit Trust ("**PIE Unit Trust**")[2]	Managed portfolio investment entity	-	-
Kiwibank RMBS Trust Series 2009-1[2]	Securitisation finance entity	-	-
Kiwi Covered Bond Trust[2]	Securitisation finance entity	-	-

[1] AMP Home Loans Limited amalgamated with Kiwibank Limited on 18 December 2020.

[2] The Banking Group consolidates the following SPVs: PIE Unit Trust, the Kiwibank RMBS Trust Series 2009-1, and the Kiwi Covered Bond Trust on the basis that Kiwibank controls these entities.

Notes to the financial statements continued

30. Related entities continued

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

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

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

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

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

- Certain shared service activities have been provided to the Banking Group in common with other NZP Group companies. The fee paid for this service is based upon activity and a mutually agreed fee.
- The Banking Group utilised a shared retail network with NZP in its provision of retail banking services to customers. The fee paid for this service was based upon activity and a mutually agreed fee. The Banking Group reimbursed KFSRL for personnel costs of $0.6m for the year ended 30 June 2021 (30 June 2020: $6.7m). As at 30 June 2021, there are no longer any shared branches staffed by KFSRL employees.
- During the year, NZP held a number of property leases on behalf of the Banking Group including shared sites. The Banking Group reimbursed NZP for the lease charges. At 30 June 2021, property leases held directly with NZP or shared sites where NZP recharge lease costs to the Banking Group are included within the lease liabilities disclosed in Note 28.
- Kiwibank is a member of, and purchases tax losses from members of, the Kiwi Group Holdings Limited Consolidated Tax Group (see Note 7).
- The Crown has entered into a $300m uncalled capital facility with KGHL where KGHL can draw down capital for contingent events around Kiwibank's conditions of registration. The annualised cost of this facility on-charged to the Banking Group by KGHL is $3.0m (30 June 2020: $3.0m).
- The Crown has entered into a Business Finance Guarantee Scheme with Kiwibank where the Crown has undertaken to indemnify the shortfall on defaulted support loans. The Crown's liability is limited to an amount equal to 80% of the shortfall of each loan. As at 30 June 2021, $108.5m of support loans have been drawn down (30 June 2020: $8.1m).
- Kiwibank provides certain shared service activities to other subsidiaries of KGHL and charges for these services are based on a mutually agreed fee for services provided. The total charged to other subsidiaries of KGHL for shared services was $2.1m (30 June 2020: $1.7m).
- On 13 November 2020, KGHL renewed and extended the loan agreement with Kiwibank, allowing KGHL to draw down $75.5m provided that the Banking Group does not exceed credit exposure to connected persons of 15% of Tier 1 capital, as required in Kiwibank's banking conditions of registration. The loan is on no more favourable terms than corresponding exposures to non-connected persons. As at 30 June 2021, the balance of the loan owed by KGHL to the Banking Group was $75.5m (30 June 2020: $75.5m).
- There is a revolving credit agreement between the Banking Group and NZHL, the balance of which was $nil at 30 June 2021 (30 June 2020: $nil).
- During the year, NZHL received commissions from the Banking Group totalling $25.4m (year ended 30 June 2020: $20.2m).
- During the year, the Banking Group received commissions on sales of insurance policies from Kiwi Insurance, a fellow subsidiary of KGHL, totalling $1.6m (year ended 30 June 2020: $2.0m).
- On 4 June 2020, the Banking Group entered into an agreement with Kiwi Insurance to provide Kiwi Cover to eligible employees. As at 30 June 2021, $0.8m was recognised as an expense in the Banking Group (30 June 2020: $0.8m).

Transactions with ACC, NZSF and Guardians of New Zealand Superannuation

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

Notes to the financial statements continued

30. Related entities continued

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

Dollars in millions	30/06/21	30/06/20
Outstanding balances		
NZP (due to related parties)	**4**	5
Other subsidiaries of KGHL (due to related parties)	**2**	2
Total due to related parties	**6**	7
Guardians of New Zealand Superannuation (deposits)	**250**	150
NZP Superannuation Plan (deposits)	**1**	-
ACC and its' related entities (deposits)	**6**	-
KGHL (deposits)	**4**	8
Other (deposits)	**17**	6
Total due to related parties included in deposits	**278**	164
Funds managed by subsidiaries of KGHL (debt securities)	**9**	9
Total due to related parties included in debt securities	**9**	9
NZP (lease liabilities)	**-**	1
Total due to related parties included in lease liabilities	**-**	1
Other subsidiaries of KGHL (subordinated debt)	**150**	150
Total due to related parties included in subordinated debt	**150**	150
Total outstanding balances due to related parties	**443**	331
Receivables		
NZP (due from related parties)	**-**	-
KGHL (due from related parties)	**76**	76
Other subsidiaries of KGHL (due from related parties)	**1**	1
Total due from related parties per balance sheet	**77**	77
NZP (right-of-use asset)	**-**	2
Total due from related parties included in right-of-use assets	**-**	2
Total receivable from related parties	**77**	79
Balances due to/from related parties per balance sheet		
Payables – current	**6**	7
Payables – non-current	**-**	-
Receivables – current	**77**	77
Receivables – non-current	**-**	-

The comparative amount for 30 June 2020 has been restated to include an additional $9.1m exposure to a related party for a debt security held with Kiwibank by an entity that is managed by a subsidiary of KGHL.

Notes to the financial statements continued

30. Related entities continued

The table below shows material transactions with related entities.

Dollars in millions	Year ended 30/06/21	Year ended 30/06/20
Interest income		
Interest received or due from NZP	-	1
Interest received or due from KGHL	2	3
Total interest income received or due from related parties	2	4
Interest expense		
Interest paid or due to Guardians of NZ Superannuation	(1)	-
Interest paid or due to NZP	-	(1)
Total interest expense paid or due to related parties	(1)	(1)
Other operating income		
Other income received or due from NZP	1	3
Other income received or due from other subsidiaries of KGHL	4	3
Total other operating income paid or due from related parties	5	6
Operating expenses		
Operating expenses paid or due to NZP	(8)	(20)
Operating expenses recovered or due from NZP	1	4
Operating expenses paid or due to other subsidiaries of KGHL	(1)	(7)
Operating expenses recovered or due from other subsidiaries of KGHL	2	3
Total operating expenses paid or due to related parties	(6)	(20)
Other transactions		
Other reimbursements paid or due to NZP	-	(2)
Other reimbursements received or due from other subsidiaries of KGHL	3	4
Commissions paid to other subsidiaries of KGHL	(25)	(20)
Assets purchased from NZP	-	(1)
Other distributions paid to other subsidiaries of KGHL	(6)	(11)

Notes to the financial statements continued

30. Related entities continued

Transactions with key management personnel

Loans made to and deposits held by key management personnel (including personally related parties) are made in the ordinary course of business on normal commercial terms and conditions, no more favourable than those given to other employees. Loans are on terms of repayment that range between fixed and variable, all of which have been made in accordance with the Banking Group's lending policies. No individually assessed provision for credit impairment has been recognised for loans made to key management personnel (30 June 2020: $nil).

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

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

Dollars in millions	**Year ended 30/06/21**	Year ended 30/06/20
Salaries and short-term benefits paid to key management personnel	**6**	**7**
Long-term incentives paid to key management personnel	**1**	-
Termination benefits paid to key management personnel	**1**	**1**

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

Dollars in millions	**30/06/21**	30/06/20
Loans to key management personnel	**1**	-
Deposits from key management personnel	**1**	1

Long-term incentive scheme

During the year ended 30 June 2021, the Bank entered into a one-off cash-based long-term incentive scheme ("**LTI**") with the senior executive team. The LTI covers the period from 1 July 2020 to 30 June 2025, and vests in three tranches. At each vesting date certain conditions are required to be met including financial and performance targets for the Banking Group.

31. Fiduciary activities, securitisation and funds under management

Accounting policy

A subsidiary of the Banking Group acts as a manager for a unit trust.

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

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

Insurance business

The Banking Group does not conduct any insurance business.

Marketing and distribution

The Banking Group markets and distributes life insurance, business and other personal insurance products provided by or arranged through a number of insurance parters. The Banking Group's insurance partners are:

- The Hollard Insurance Company Pty Limited for house, contents, and car insurance;
- Tower Insurance Limited for travel insurance;
- Kiwi Insurance Limited for life insurance; and
- business insurance is administered by Aon New Zealand and underwritten by AIG.

Securitised assets

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

31. Fiduciary activities, securitisation and funds under management continued

Funds management

A subsidiary of Kiwibank also acts as the manager for the Kiwibank PIE Unit Trust. These funds are invested in products of Kiwibank and are recorded as liabilities in the balance sheet (see Note 18). At 30 June 2021, $4,436m of funds under management were invested in Kiwibank's own products or securities (30 June 2020: $4,707m).

Provision of financial services

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

The Banking Group has not provided any funding to entities which conduct the following activities during the years ended 30 June 2021 and 30 June 2020:

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

Risk management

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

32. Segment analysis

Accounting policy

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

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

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

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

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

No revenue from transactions with a single external customer or counterparty amounted to 10% or more of the Banking Group's total revenue (2020: nil).

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

Notes to the financial statements continued

32. Segment analysis continued

	30/06/21			30/06/20		
Dollars in millions	Personal	Business	Total	Personal	Business	Total
Income statement						
Net interest income	**334**	**194**	**528**	287	168	455
Net gains on financial instruments	**(1)**	**9**	**8**	2	11	13
Other operating income	**29**	**12**	**41**	54	11	65
Segmental revenue	**362**	**215**	**577**	343	190	533
Operating expenses	**(313)**	**(109)**	**(422)**	(302)	(106)	(408)
Profit before credit impairment and taxation	**49**	**106**	**155**	41	84	125
Credit impairment reversal/(losses)	**20**	**(1)**	**19**	(32)	(19)	(51)
Profit before taxation	**69**	**105**	**174**	9	65	74
Balance sheet						
Net loans and advances	**21,838**	**3,369**	**25,207**	19,680	2,550	22,230
Customer deposits	**18,183**	**4,216**	**22,399**	17,417	3,180	20,597

[1] In the current period, the Banking Group has renamed 'Net fee and other income' to 'Other operating income', and reclassified certain operating expenses to direct fee expenses or to net amounts against gross revenue within 'Other operating income'. Comparatives have been reclassified as follows to align with the current year's presentation: 'Operating expenses' and 'Other operating income' have decreased by $20m for the year ended 30 June 2020 and classifications have been aligned with the Income Statement and internal reporting.

33. Risk management

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

The Banking Group risks are identified, managed, mitigated and monitored using a risk management framework that embeds risk accountability and responsibility throughout the organisation. This is the foundation for the delivery of effective risk control.

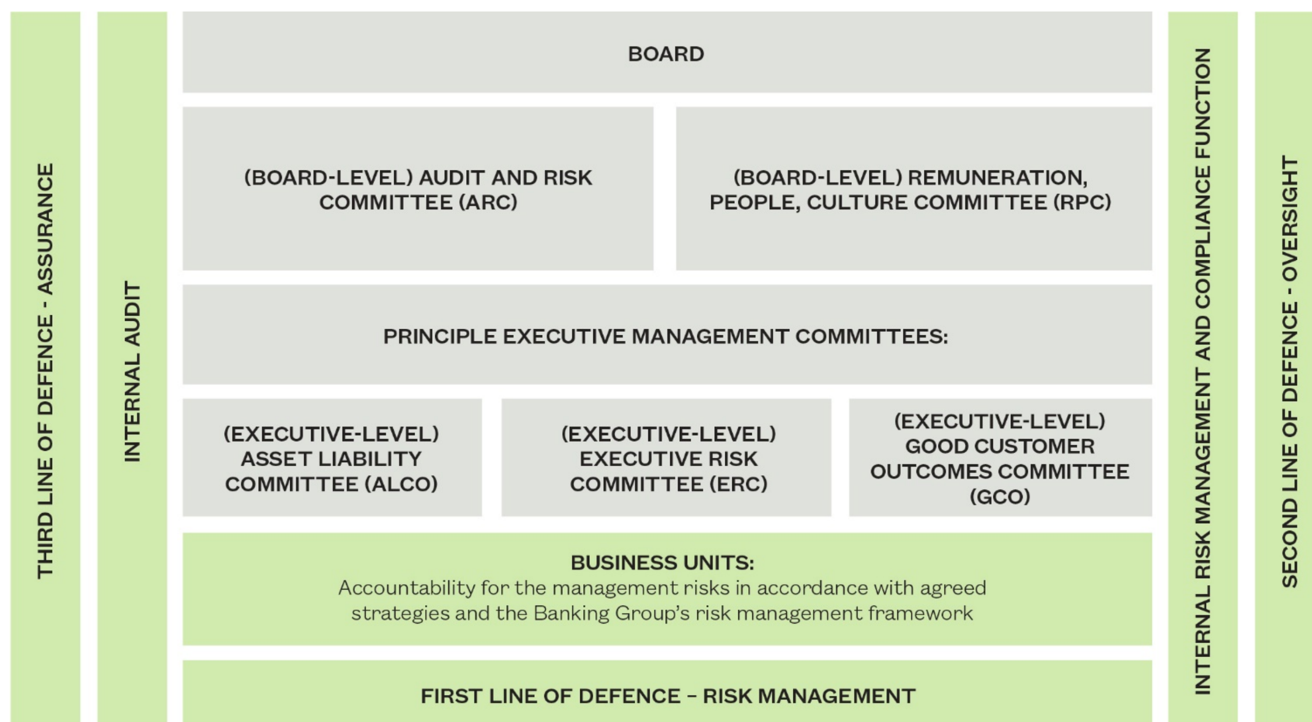
Organisational perspective

The Banking Group supports the risk management framework with an organisational governance framework that is characterised by three lines of defence, which separate risk management, oversight and assurance.

Governance is maintained through delegation of authority from the Board down to employees. Executives are supported by an Executive and Management Committee structure which is designed to ensure open challenge and enable effective decision-making.

Notes to the financial statements continued

33. Risk management continued



The Board has the primary responsibility for effective risk management by:

- establishing and overseeing the Banking Group's Enterprise Risk Management Framework ("**ERMF**") including the material risk classes and the associated risk appetite and key policies for each of the risk classes;
- monitoring the aggregate risk exposures and emerging risks and setting behaviour expectations; and
- ensuring the Executive Management team sets and maintains mechanisms to identify, measure, and control exposures and risks along with complying with regulation and law.

The Board has delegated authority, which includes frequent and detailed monitoring of the financial and non-financial metrics to the Audit and Risk Committee ("**ARC**") with internal governance via the principal management committees. The ARC reports regularly to the Board on its activities and is responsible for:

- reviewing and recommending to the Board, approval of the Banking Group's frameworks and key policies for managing business, credit, market and operational risk and maintaining an effective ERMF;
- monitoring the management of the Banking Group's key risks, performance, exposures against limits, and capital adequacy levels;
- monitoring anticipated changes in the economic and business environment and other factors relevant to the Banking Group's risk profile;
- setting and monitoring risk appetite and assessing the overall risk profile of the Banking Group within material risk types;
- reviewing internal audit activities and significant audit issues; and
- reviewing financial and disclosure statements.

The Banking Group has an independent risk management function, as a second line of defence, headed by the Chief Risk Officer ("**CRO**") who:

- is responsible for overseeing the risk profile and the risk management framework;
- can effectively challenge activities and decisions that materially affect the Banking Group's risk profile; and
- has an independent reporting line to the ARC to enable the appropriate escalation of concerns, issues or risks.

33. Risk management continued

The Risk Management function comprises the following teams which operate alongside the Banking Group's business units:

- (Retail and Business) Credit risk;
- Market risk;
- Operational risk and reporting;
- Compliance;
- Security, Safety and Continuity;
- Anti-Money Laundering ("**AML**"); and
- Portfolio Management.

These teams are responsible for an independent appraisal of the business units' risk positions and their overall control environments. Where applicable, they identify and quantify risks e.g. credit, market, liquidity, operational and compliance risks, and work as subject matter experts with the business units to implement appropriate policies, procedures and controls to manage/mitigate risks.

The Banking Group, through its training, management standards and procedures, aims to maintain a disciplined and robust control environment in which all employees understand their roles and obligations.

No formal reviews of the Banking Group's risk management system were undertaken by external parties during the year ended 30 June 2021.

Internal audit

The Banking Group has an independent internal audit function, which appraises the adequacy and effectiveness of the internal control environment, and reports results to management and the ARC. The internal audit function reports functionally to the Chair of the ARC and administratively to the Chief Financial Officer.

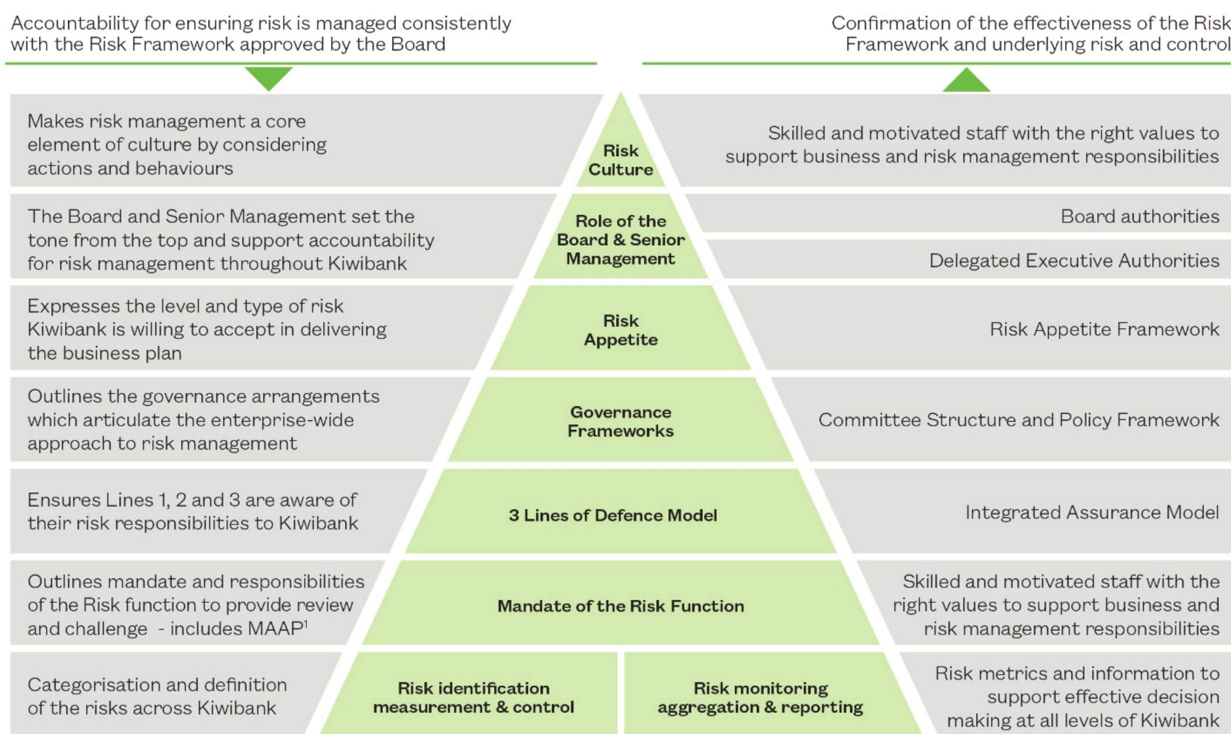
In planning audit activities, internal audit adopts a risk-based approach that directs and concentrates resources to those areas of greatest significance, strategic concern and risk to the business. This encompasses reviews of major credit, market, technology, programmes, projects and operating risks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

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

Enterprise risk management framework ("ERMF")

The Banking Group regards the management of risk to be a fundamental management activity performed at all levels of the business and the ERMF is designed to achieve this. The ERMF is built around a sound risk culture and sets out the minimum standards for risk management across all risk types embedded within a range of frameworks and policy statements.

The diagram below explains the structure and high-level components of the Banking Group's ERMF:



1. Management Assurance Attestation Programme

Notes to the financial statements continued

33. Risk management continued

The key requirements of the risk management framework are the:

- Risk appetite statements

The Board is responsible for approving the Banking Group's Risk Appetite Framework ("**RAF**") annually. The RAF is a key element of the ERMF, as it expresses the amount and type of risk (qualitative risk appetite statements and quantitative metrics) the Banking Group is willing to accept in pursuing its strategic objectives.

Board-level tolerances are formally cascaded into more detailed executive and management business appetite metrics and limits to support decision-making.

- Governance frameworks

The Banking Group uses risk management governance frameworks for all domains within the ERMF, supported by detailed policies and standards.

- Three lines of defence model

The 'three lines of defence' governance approach to risk management is standard practice within the financial services sector. It ensures a clear delineation of responsibilities between control over day-to-day operations, risk monitoring/oversight and independent assurance activities. This risk management approach ensures holistic end-to-end management of risk, where all employees play an active role in identifying and managing risk and operating within the Banking Group's risk profile.

The 1st Line of Defence (Operational Management/Business Units)	The 2nd Line of Defence (Risk Management And Compliance Functions)	The 3rd Line of Defence (Internal Audit)
Consists of the business area whose role is to identify risk then take action to manage and treat the risk in line with appetite. As the business understands its day to day activities they are best placed to effectively manage their risks.	Sets standards through establishing policies, procedures and providing risk oversight specialists (e.g., compliance functions, legal and enterprise risk management). The 2nd line will provide support and challenge to the first line risk management activities and report direct to the Board.	Provides independent assurance to the Board. Internal Audit adds value and improves Kiwibank's operations by helping to evaluate and improve the effectiveness of risk management, control and governance processes.

- Monitoring and oversight of risk limits

Regular monitoring and comprehensive reporting to all levels of management and the Board ensures appetite limits are maintained and subject to stress analysis at a risk-type and portfolio level as appropriate. Stress testing is a risk management tool that the Banking Group uses to support an understanding of the vulnerabilities within the business model. The Banking Group undertakes an annual programme of stress-testing activity as part of the Internal Capital Adequacy Assessment Programme ("**ICAAP**"), which informs the planning process and the calibration of risk appetite.

Specific areas of risk management

The primary risk classes arising from the activities of the Banking Group are:

- Credit Risk – the risk of financial loss where a customer or counterparty fails to meet any financial or contractual obligation.
- Market Risk – the potential for losses arising from adverse changes in market factors, such as interest rates, foreign exchange rates, and credit spreads.
- Liquidity Risk - the risk that the Banking Group cannot meet its financial and transactional cash-flow obligations as they fall due and the risk of loss of access to funding channels.
- Capital Risk – the risk that the Banking Group has insufficient capital or sub-optimal quality of capital to allow strategic initiatives to be undertaken or that capital is inefficiently deployed.
- Operational Risk – the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk.
- Business Risk – macro or micro environmental events that could impede or prevent the Banking Group achieving its stated business goals or strategies, including missed opportunities and potential losses/damage arising from poor strategic business decisions. This risk includes material changes in the global and domestic economic environment impacting credit and liquidity flows.

Operational Risk, Conduct Risk and Regulatory Compliance are applicable across all risk domains.

Within the context of the risk classes above, the Banking Group continually identifies, assesses and monitors emerging risks through the ERMF. These are new or evolving risks where the impact is uncertain and the probability, timescale and/or materiality may be difficult to accurately assess. Emerging risks can cover risks such as technology, reputation and sustainability risks and operational resilience (including cyber crime). The Banking Group reviews these risks on a periodic basis.

33. Risk management continued

1. Credit Risk

Credit risk overview, management and control responsibilities

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

The credit risk management framework ensures a consistent approach is applied across the Banking Group to measure, monitor and manage the credit risk appetite set by the Board. The Board requires sound lending growth for appropriate returns, and is assisted and advised by the ARC in discharging its duty to oversee risk. The ARC:

- sets the credit risk appetite, credit risk framework, credit strategies, credit approval authorities' framework and material credit policies;
- ensures that the Banking Group has in place and maintains credit policies and portfolio standards consistent with responsible lending standards designed to achieve portfolio outcomes consistent with the Banking Group's risk/return expectations and regulatory obligations; and
- approves credit transactions beyond the discretion of executive management.

Day-to-day management of credit risk is performed and reported by the Banking Group's Risk Management functions, with monitoring by the Credit Risk Committee and oversight by the Banking Group's Executive Risk Committee ("**ERC**").

Key elements of the credit risk management framework:

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

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

  The output from these models supports the Banking Group's day-to-day credit risk management decisions including origination, pricing, approval levels, regulatory capital adequacy, internal capital allocation and credit provisioning.

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

- **Portfolio structure, measurement and monitoring** – The Banking Group's credit portfolio is divided into two asset classes: retail and corporate. The retail asset class is comprised of housing loan, credit card and personal lending facilities and small-to-medium-enterprise business lending. This segment is managed on a delinquency band approach and on a behavioural basis.

  The corporate asset class consists of lending to middle market and corporate businesses. Each exposure is assigned an internal risk rating that is based on an in-depth assessment of the risk of default to provide a consistent framework for reporting and analysis.

  These exposures are required to be reviewed on an annual basis. The overall composition and quality of the credit portfolios is monitored taking into account the potential changes in economic conditions. Refer to Note 9 Credit impairment losses for the detailed accounting policy.

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

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

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

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

- **Credit risk mitigation** – The Banking Group's Board-approved wholesale credit management policy sets out the parameters for which it can enter into credit exposures arising from on- and off-balance sheet transactions. This policy requires a maximum limit be set in respect of credit risk associated with the counterparty based on their credit rating, the types of instruments issued and the maturity profile. The Banking Group also has legal arrangements with its major institutional counterparties to allow netting of off-balance sheet exposures, along with collateral management arrangements.

33. Risk management continued

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

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

  The Banking Group's accounting policies regarding impairment and allowances for expected credit losses are covered in Note 9.

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

Credit quality of loans and advances and undrawn credit commitments

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

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

	30/06/21				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Credit exposure by risk grade					
Risk bands:					
0 – 3	**17,740**	**125**	**-**	**-**	**17,865**
4 – 5	**7,467**	**491**	**-**	**-**	**7,958**
6 – 7	**3,249**	**384**	**-**	**-**	**3,633**
8 – 9	**17**	**86**	**-**	**-**	**103**
10 – 12	**-**	**-**	**22**	**1**	**23**
Total credit exposure by risk grade	**28,473**	**1,086**	**22**	**1**	**29,582**

	30/06/20				
	Stage 1	Stage 2	Stage 3		
Dollars in millions	Collectively assessed	Collectively assessed	Collectively assessed	Individually assessed	Total
Credit exposure by risk grade					
Risk bands:					
0 – 3	16,301	44	-	-	16,345
4 – 5	6,421	454	-	-	6,875
6 –7	2,456	325	-	-	2,781
8 – 9	10	94	-	-	104
10 – 12	-	-	27	3	30
Total credit exposure by risk grade	25,188	917	27	3	26,135

Comparatives have been restated to include $3,827m of off-balance sheet credit commitments.

33. Risk management continued

Credit quality of investment securities

All investment securities held by the Banking Group are investment grade, primarily AAA rated, and considered low risk.

Impacts of climate change on credit risk

Kiwibank recognises that climate change will have a significant impact on New Zealand's environment and economy. The physical and transition risks created by climate change will impact a number of the Banking Group's risk domains, as the Bank's risk management policies and practices adapt to these emerging impacts. The Banking Group is progressing analysis of the impacts of climate risk, and sea level rises in particular, on the Banking Group's credit risk.

Refer to section 6 Business Risk *Climate change management* for more detail on the work underway by the Banking Group to monitor, assess and manage this risk.

2. Market Risk

Market risk arises from the Bank's balance sheet management and trading activities, exposure to movements in interest rates and foreign exchange rates, and from any mismatch in maturity and repricing dates between assets and liabilities.

The Audit and Risk Committee ("**ARC**") approves Market Risk Policies, and delegates management oversight of the market risk framework to the Bank's Asset and Liability Committee ("**ALCO**"). The Market Risk Policies establish market risk limits for non-traded and traded market risk which Treasury and Financial Markets must comply with. The Market Risk team independently reports and monitors market risk against limits daily.

Market risk is primarily measured and controlled using Value at Risk ("**VaR**") and sensitivity analysis.

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

Traded Market Risk

The Banking Group's financial markets are predominantly exposed to interest rate risk and currency risk from sales of financial markets products to customers, and is managed within traded market risk limits. Traded market risk is primarily measured and controlled using VaR and sensitivity analysis.

Trading VaR is calculated using historical simulation of market valuations using 260 business days of historical interest rate and currency movements, at a 95% confidence level and a 1-day holding period.

Trading VaR is hedged within risk limits and is not material.

Non-Traded Market Risk

The Banking Group's balance sheet is predominantly exposed to interest rate risk from asset and liability repricing mismatches from providing banking products and services to customers, and the Banking Group's funding and liquidity management. Currency risk is hedged within risk limits and is not material. Interest rate risk is measured and controlled using interest rate sensitivity analysis and position limits, within non-traded market risk limits.

Interest rate risk management

The main objective of the management of interest rate risk is to achieve a balance between reducing risk to earnings from the adverse effect of interest rate movements and enhancing net interest income through the correct anticipation of the direction and extent of interest rate changes. Interest rate risk is managed by the treasury business unit within approved limits.

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

Interest rate sensitivity

The table below summarises the sensitivity to changes in interest rates in the banking book. The Basis Point Sensitivity ("**BPS"**) calculates the absolute net impact of a reasonably possible movement in interest rates.

Dollars in millions	**30/06/21**	30/06/20
Banking Book +/- 100 BPS	**17**	17

Notes to the financial statements continued

33. Risk management continued

Interest rate repricing schedule

The following tables present a breakdown of the Banking Group's assets, liabilities and off-balance sheet instruments at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The Banking Group does not manage its interest rate risk on the basis of the information below.

	30/06/21						
Dollars in millions	Total	Non-interest bearing	Up to 3 months	Over 3 to 6 months	Over 6 months to 1 year	Over 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	715	51	664	-	-	-	-
Due from related parties	77	1	76	-	-	-	-
Due from other financial institutions	26	-	26	-	-	-	-
Investment securities	1,704	-	223	17	19	320	1,125
Derivative financial instruments	228	228	-	-	-	-	-
Loans and advances	25,207	46	8,441	4,104	7,009	2,602	3,005
Other financial assets	30	30	-	-	-	-	-
Total financial assets	27,987	356	9,430	4,121	7,028	2,922	4,130
Financial liabilities							
Due to other financial institutions	(718)	(8)	(637)	(12)	(61)	-	-
Due to related parties	(6)	(6)	-	-	-	-	-
Deposits and other borrowings	(22,399)	(4,576)	(12,454)	(3,072)	(1,926)	(217)	(154)
Derivative financial instruments	(195)	(195)	-	-	-	-	-
Debt securities issued	(2,544)	-	(1,091)	(155)	(127)	(156)	(1,015)
Other financial liabilities	(43)	(43)	-	-	-	-	-
Lease liabilities	(119)	(119)	-	-	-	-	-
Subordinated debt	(415)	-	-	-	-	-	(415)
Total financial liabilities	(26,439)	(4,947)	(14,182)	(3,239)	(2,114)	(373)	(1,584)
On-balance sheet gap	1,548	(4,591)	(4,752)	882	4,914	2,549	2,546
Net derivative notional principals	3	-	5,432	(1,672)	(1,880)	(1,050)	(827)
Net effective interest rate gap	1,551	(4,591)	680	(790)	3,034	1,499	1,719

33. Risk management continued

Interest rate repricing schedule continued

	30/06/20						
Dollars in millions	Total	Non-interest bearing	Up to 3 months	Over 3 to 6 months	Over 6 months to 1 year	Over 1 and 2 years	Over 2 years
Financial assets							
Cash and cash equivalents	492	62	430	-	-	-	-
Due from related parties	77	1	76	-	-	-	-
Due from other financial institutions	105	-	105	-	-	-	-
Investment securities	1,895	-	308	40	440	36	1,071
Derivative financial instruments	434	434	-	-	-	-	-
Loans and advances[1]	22,230	25	6,282	3,036	6,898	4,881	1,108
Other financial assets	27	27	-	-	-	-	-
Total financial assets	25,260	549	7,201	3,076	7,338	4,917	2,179
Financial liabilities							
Due to other financial institutions	(317)	(10)	(307)	-	-	-	-
Due to related parties	(7)	(7)	-	-	-	-	-
Deposits and other borrowings	(20,597)	(3,353)	(12,170)	(3,049)	(1,546)	(265)	(214)
Derivative financial instruments	(400)	(400)	-	-	-	-	-
Debt securities issued	(2,229)	-	(571)	(420)	(235)	-	(1,003)
Other financial liabilities	(70)	(70)	-	-	-	-	-
Lease liabilities	(97)	(97)	-	-	-	-	-
Subordinated debt	(150)	-	-	-	-	-	(150)
Total financial liabilities	(23,867)	(3,937)	(13,048)	(3,469)	(1,781)	(265)	(1,367)
On-balance sheet gap	1,393	(3,388)	(5,847)	(393)	5,557	4,652	812
Net derivative notional principals	75	-	6,266	(503)	(3,270)	(2,939)	521
Net effective interest rate gap	1,468	(3,388)	419	(896)	2,287	1,713	1,333

[1]In the current period, when the provision for the credit impairment exceeds the carrying amount of the drawn balances, the excess has been presented as 'Other liabilities' to reflect the expected credit loss for undrawn commitments. Comparatives have been restated to align with the current year's presentation. Therefore, 'Loans and advances' and 'Other liabilities' as at 30 June 2020 have been increased by $8m.

Notes to the financial statements continued

33. Risk management continued

Currency risk management

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

The Banking Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Board sets limits on the level of exposure by currency and in aggregate for overnight positions, which are monitored daily.

The Banking Group does not carry any material net foreign currency exposure.

Equity Risk

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

3. Liquidity Risk

Liquidity and funding risk overview, management and control responsibilities

Liquidity risk is the risk that the Banking Group will not have sufficient funds available to meet its financial and transactional cash-flow obligations. Funding risk contributes to overall liquidity risk, but is concerned with the Banking Group's capacity to fund increases in assets while meeting its payment obligations, including repaying depositors and managing maturing wholesale debt. There is the risk of over-reliance on a funding source or not having the appropriate amount, tenor and composition of funding and liquidity.

Management of liquidity risk is designed to ensure that the Banking Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis.

Funding and liquidity is measured by and managed in accordance with the policies and processes defined in the Board-approved Liquidity Framework and Liquidity Policy. The Banking Group's Liquidity Framework and Liquidity Policy set out the Banking Group's funding and liquidity risk appetite; roles and responsibilities of key people managing funding and liquidity risk within the Banking Group; risk reporting and control processes; and limits and targets used to manage the Banking Group's balance sheet.

The Treasury business unit has day-to-day responsibility for liquidity management and monitoring the Banking Group's funding base ensuring that this base is prudently maintained and adequately diversified under oversight of the ALCO.

Measuring and monitoring liquidity and funding risk

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

The Banking Group maintains a Contingency Funding Plan ("**CFP**") which defines an approach for responding to liquidity-threatening events. The CFP establishes policies, responsibilities and plans which are designed to return the Banking Group to a robust position within risk tolerance in the event of a liquidity crisis.

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

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

Notes to the financial statements continued

33. Risk management continued

Liquidity risk management process

The Banking Group's liquidity management responsibilities include:

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

Liquid assets portfolio

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

	30/06/21	30/06/20
Cash, balances with central bank, and certain foreign currency deposits	**651**	437
Certificates of deposit	**140**	76
Government bonds and treasury bills	**568**	651
Local body stock and bonds	**164**	133
Other bonds	**623**	717
Total	**2,146**	2,014

The Bank also held unencumbered internal residential mortgage-backed securities which would entitle the Banking Group to enter into repurchase transactions with a value of $2,163m at 30 June 2021 (30 June 2020: $1,050m).

Notes to the financial statements continued

33. Risk management continued

Maturity analysis of financial liabilities

The following tables present the Banking Group's cash flows for financial liabilities by remaining contractual maturities at the reporting date. The amounts disclosed in the table are the contractual undiscounted cash flows and include principal and future interest cash flows, therefore may not agree to the carrying values reported on the balance sheet. The Banking Group does not manage liquidity risk on the basis of the information provided below.

	30/06/21						
Dollars in millions	On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Gross nominal inflow/ outflow	Carrying amount
Non-derivative cash flows							
Financial liabilities							
Due to other financial institutions	(645)	-	(73)	-	-	(718)	(718)
Due to related parties	(6)	-	-	-	-	(6)	(6)
Deposits and other borrowings	(11,769)	(5,327)	(5,016)	(336)	-	(22,448)	(22,399)
Debt securities issued	(65)	(83)	(616)	(1,751)	(176)	(2,691)	(2,544)
Other financial liabilities	(43)	-	-	-	-	(43)	(43)
Lease liabilities	-	(4)	(13)	(54)	(66)	(137)	(119)
Subordinated debt	-	(2)	(5)	(298)	(150)	(455)	(415)
Total	(12,528)	(5,416)	(5,723)	(2,439)	(392)	(26,498)	(26,244)
Derivative cash flows – net							
Interest rate derivatives	(3)	-	(4)	25	(1)	17	
Total	(3)	-	(4)	25	(1)	17	
Derivative cash flows – gross							
Foreign exchange derivatives							
Inflow	145	199	364	1,122	176	2,006	
Outflow	(147)	(199)	(362)	(1,109)	(178)	(1,995)	
Total	(2)	-	2	13	(2)	11	
Off-balance-sheet cash flows							
Capital commitments	-	(5)	-	-	-	(5)	
Undrawn credit commitments	(4,321)	-	-	-	-	(4,321)	
Total	(4,321)	(5)	-	-	-	(4,326)	

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

Notes to the financial statements continued

33. Risk management continued

Dollars in millions	30/06/20 On demand	Up to 3 months	3 to 12 months	Between 1 and 5 years	More than 5 years	Gross nominal inflow/ outflow	Carrying amount
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(317)	-	-	-	-	(317)	(317)
Due to related parties	(7)	-	-	-	-	(7)	(7)
Deposits and other borrowings	(9,418)	(6,174)	(4,667)	(437)	-	(20,696)	(20,597)
Debt securities issued	-	(127)	(676)	(1,330)	(177)	(2,310)	(2,229)
Other financial liabilities	(70)	-	-	-	-	(70)	(70)
Lease liabilities	(1)	(2)	(12)	(53)	(47)	(115)	(97)
Subordinated debt	-	-	-	-	(150)	(150)	(150)
Total financial liabilities	(9,813)	(6,303)	(5,355)	(1,820)	(374)	(23,665)	(23,467)
Derivative cash flows – net							
Interest rate derivatives	(11)	(8)	(53)	2	-	(70)	
Total	(11)	(8)	(53)	2	-	(70)	
Derivative cash flows – gross							
Foreign exchange derivatives							
Inflow	161	143	536	472	177	1,489	
Outflow	(163)	(143)	(477)	(427)	(180)	(1,390)	
Total	(2)	-	59	45	(3)	99	
Off-balance-sheet cash flows							
Capital commitments	(1)	(5)	-	-	-	(6)	
Undrawn credit commitments	(3,827)	-	-	-	-	(3,827)	
Total	(3,828)	(5)	-	-	-	(3,833)	

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

33. Risk management continued

4. Capital Risk

Capital risk is the risk that the Banking Group has insufficient capital or sub-optimal quality of capital to allow strategic initiatives to be undertaken or that capital is inefficiently deployed. It is also the risk of loss arising from the Banking Group's failure to maintain the level of capital required by prudential regulators and other key stakeholders such as shareholders, debt investors, depositors, and rating agencies.

The Banking Group's capital management strategy seeks to ensure the Banking Group is adequately capitalised while recognising capital is often an expensive form of funding or insurance. The Banking Group seeks to maintain and acquire capital in an economically effective manner so as to: i) support future development and growth aspirations; ii) comply with regulatory capital requirements; iii) maintain a strong internal capital base to cover all material inherent risks; and iv) maintain an investment grade credit rating.

The Banking Group undertakes a programme of activities designed to ensure that it has sufficient financial resources to continue as a going concern even if it suffers a material unforeseen or unexpected risk event(s). The Banking Group's Internal Capital Adequacy Assessment Programme ("**ICAAP**") deals primarily with assessing its capacity to absorb risk based on: i) identification and quantification of its immediate risks; and ii) comparison of those risks with its financial capital (that may have to be sacrificed if these risks materialise). The Board of Directors have ultimate responsibility for capital adequacy and approve capital policy and minimum internal capital levels and limits. Refer to Note 29 Equity, and Capital Adequacy and Regulatory Liquidity Ratios for detailed analysis of the Banking Group's capital management.

5. Operational Risk

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

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

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

Operational risk covers a broad spectrum of activities, and is aligned to Basel-defined categories.

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

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

6. Business Risk

Business risk is a strategic risk. There are numerous external and internal uncertainties that may derail the business strategies or goals of the Banking Group.

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

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

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

Notes to the financial statements continued

33. Risk management continued

COVID-19 management

The Banking Group took a number of actions to manage the operational challenges resulting from COVID-19 and this has changed Kiwibank's ways of operating. The changes include additional IT investment undertaken to reduce systems risk and to enable staff to work from home, the roll out of termporary customer support arrangements to impacted customers, the establishment of the Business Finance Guarantee Loans Scheme, and additional steps taken to ensure liquidity is maintained.

The Banking Group has processes in place, including Board governance meetings when required, to manage the day-to-day impacts and the changing risk levels (heightened liquidity risk, credit risk, customer risk, market risk, operational risk and business risk) within each lockdown Alert Level. The Banking Group's Note 9 discloses the impact of COVID-19 on credit impairment losses and credit impairment provisions.

Climate change management

The Bank recognises climate change will have a significant impact on New Zealand's environment and economy. The key risks are financial and non-financial, derived from both physical risks (climate and weather-related events) and transition risks resulting from the process of adjustment towards a low carbon economy. The focus on these risks by key stakeholders including businesses, clients, shareholders, governments and regulators is increasing, aligned with the evolving societal, regulatory and political landscape.

The sections below summarise Kiwibank's current approach to managing climate change risks, across the four Task Force on Climate-related Financial Disclosures ("**TCFD**") thematic areas:

- *Governance:* The ARC has responsibility for the oversight of of all risk domains, which includes managing climate risk, as delegated by the Board. An internal sustainability working group is developing the Bank's strategic response to climate risk in line with the recommendations of the TCFD. A Climate Action Plan identifying material climate change risks was endorsed by the Board in February 2020.
- *Strategy:* The Bank's strategy to address climate change includes work on how to disclose and manage the impacts associated with climate change on the Bank's business, including how to reduce the Bank's emissions.
- *Risk Management:* The Bank continues to develop its climate change risk management framework to ensure Kiwibank's activities appropriately consider climate-related risks and opportunities. Climate change extends across multiple risk domains e.g. credit, market, operational, capital and business.
- *Metrics and Targets:* The Bank has current metrics and targets related to its carbon emissions created through its operations, but excluding financed emissions. The Bank is also progressing analysis of the exposure to climate risk, and sea level rises in particular, and will incorporate the identified risks into risk management policies as the analysis is completed.

The TCFD is the likely framework that the New Zealand Government will use for the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill.

The Bank is continuing to develop its modelling and assessment capabilities to quantify climate change impacts, including building a greater understanding through climate scenario analysis.

TCFD requires an organisation to review internal processes and operations/activities against climate-related risks. The Bank is using a mix of internal analysis and the procurement of technical information from specialised third parties in order to identify, understand and ultimately disclose in accordance with TCFD.

A Climate Risk Report will be released by the end of the 2021 calendar year in relation to the 30 June 2021 financial year that provides further analysis of climate risk management.

34. Auditor's remuneration

Dollars in thousands	**Year ended 30/06/21**	Year ended 30/06/20
Auditor's remuneration		
Audit and review of financial statements	**1,091**	938
Other services:		
Other assurance services[1]	**8**	7
Other services[2]	**15**	83
Total Auditor's remuneration	**1,114**	1,028

[1] Other assurance services relate to register compliance assurance and compliance with certain matters in the Trust Deed in respect of a controlled entity of Kiwibank (2020: register compliance assurance and compliance with certain matters in the Trust Deed in respect of a controlled entity of Kiwibank).

[2] Other services include agreed-upon procedures in respect of a controlled entity of Kiwibank (2020: agreed-upon procedures in respect of a controlled entity of Kiwibank, capital models integrity check and provision of Kiwibank whistle-blower services).

Notes to the financial statements continued

35. Capital expenditure commitments

Capital expenditure commitments contracted for as at 30 June 2021, but not provided for in these financial statements, total $4.6m (30 June 2020: $6.3m) and are analysed by expected maturity in Note 33.

36. Contingent liabilities and credit commitments

Accounting policy

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

Compliance, regulation and remediation

The Banking Group is subject to regulatory oversight and also regularly assesses compliance with product terms and conditions and relevant legislation to identify any potential remediation claims in relation to the provision of services to customers. A contingent liability may exist, in respect of actual or potential claims, where the law is uncertain, or the potential liability cannot accurately be determined. All potential remediation claims are assessed on a case-by-case basis. Where the Banking Group has carried out an assessment of likely loss, and, where it can be reliably estimated, an appropriate provision is recognised. Any material claim that has not yet met the conditions to be recognised is disclosed as a contingent liability.

Loan commitments

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

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

Dollars in millions	**30/06/21**	30/06/20
Letters of credit and performance-related contingencies	**60**	47
Loan commitments	**4,261**	3,780
Total undrawn credit commitments	**4,321**	3,827

37. Events subsequent to the reporting date

COVID-19 pandemic update

Following the confirmation of community spread of the COVID-19 Delta variant, the Government announced on 17 August New Zealand's COVID-19 Alert Levels changed, with the Auckland region and Coromandel Peninsula moving to Alert Level 4 for seven days and the rest of New Zealand moving to Alert Level 4 for three days. Subsequent announcements were made extending the lockdown for all of New Zealand until 27 August, with the Auckland region further extended until 31 August. As described in note 9, the Banking Group's expected credit losses are sensitive to changes in future economic forecasts. The forecast assumptions applied at 30 June 2021 remain reasonable and incorporated the risk of further lockdowns and the related economic impacts on borrowers. Therefore, the recent changes in COVID-19 Alert Levels did not result in changes in credit impairment provisions recognised as at 30 June 2021.

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

Capital adequacy and regulatory liquidity ratios

Unaudited

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

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

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

Regulatory capital

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

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

Capital ratios

	The Banking Group	
	30/06/21	30/06/20
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	**10.9%**	11.4%
Tier 1 capital ratio	**11.9%**	12.6%
Total capital ratio	**13.2%**	12.6%
RBNZ minimum ratios		
Common Equity Tier 1 capital ratio	**4.5%**	4.5%
Tier 1 capital ratio	**6.0%**	6.0%
Total capital ratio	**8.0%**	8.0%
Buffer ratios		
Buffer ratio	**5.2%**	4.6%
Buffer ratio requirement	**2.5%**	2.5%

	Kiwibank Limited	
	30/06/21[1]	30/06/20
Capital adequacy ratios		
Common Equity Tier 1 capital ratio	**10.9%**	11.1%
Tier 1 capital ratio	**11.9%**	12.2%
Total capital ratio	**13.2%**	12.2%

[1] When calculating the current year's Kiwibank Limited solo capital ratios, the Bank has applied a clarification of the scope of the entities consolidated within the solo calculation contained within BPR100 Capital Adequacy released by RBNZ on 17 June 2021. The effect was to consolidate Kiwibank's internal RMBS Trust. The ratios for the year ended 30 June 2020 have not been updated to reflect this clarification.

Capital adequacy and regulatory liquidity ratios continued

Ordinary shares

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

a) each share contains a single right to vote;
b) there are no redemption, conversion or capital repayment options/facilities;
c) there is no predetermined dividend rate;
d) there is no maturity date;
e) there are no options to be granted pursuant to any agreement; and
f) ordinary shares rank equally to dividends and any surpluses on winding up.

Perpetual capital bonds

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

a) the perpetual capital bonds constitute direct, perpetual, convertible, non-cumulative, unsecured, subordinated debt securities issued by Kiwibank;
b) interest on the perpetual capital bonds is payable quarterly in arrear subject to the absolute discretion of Kiwibank;
c) interest was paid on the perpetual capital bonds at a fixed rate of 7.25% until 27 May 2020 when it was reset to 3.985%, effective until the next reset date of 27 May 2025;
d) interest is non-cumulative;
e) the perpetual capital bonds may be required to be converted into ordinary shares of Kiwibank Limited (or written off if conversion into ordinary shares is not possible) if certain events occur;
f) the perpetual capital bonds have no voting rights;
g) the perpetual capital bonds do not have a maturity date; however, subject to meeting certain conditions, Kiwibank may elect to make early repayment on a reset date, or following a Regulatory Event or a Tax Event. RBNZ changes to Kiwibank's conditions of registration on 2 April 2020 meant that Kiwibank was not permitted to repay the bonds on the first reset date of 27 May 2020; and
h) the perpetual capital bonds are not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Subordinated notes

The subordinated notes, issued by the Bank on 11 December 2020, which are fully paid, are included within Tier 2 capital. The subordinated notes are subordinate to all other general liabilities of the Banking Group and are denominated in New Zealand dollars. The terms and conditions include:

a) the subordinated notes constitute direct, unsecured subordinated debt obligations of Kiwibank;
b) the subordinated notes pay interest quarterly in arrear at an initial rate of 2.36% p.a., subject to the condition that Kiwibank and the Banking Group is solvent after each payment;
c) unpaid interest accumulates;
d) the subordinated notes have no voting rights;
e) the subordinated notes may be written off in certain circumstances;
f) the subordinated notes have a maturity date of 11 December 2030; however, Kiwibank may elect to make early repayment on 11 December 2025 or any quarterly interest payment date thereafter; and
g) the subordinated notes are not guaranteed by any member of the Banking Group, Kiwibank's parent companies (including New Zealand Post), the Crown or by any other person.

Risk-weighted exposures

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

Capital adequacy and regulatory liquidity ratios continued

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

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

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

The capital adequacy tables on the following pages summarise the composition of regulatory capital and capital adequacy ratios for the year ended 30 June 2021. Throughout the period, Kiwibank and the Banking Group complied with both regulatory and internal capital adequacy requirements.

Regulatory capital

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

Dollars in millions	The Banking Group 30/06/21
Common Equity Tier 1 capital	
Issued and fully paid-up share capital	**737**
Retained earnings (net of appropriations)	**967**
Accumulated other comprehensive income and other disclosed reserves[1, 2]	**20**
Less deductions from Common Equity Tier 1 capital	
Intangible assets	**(50)**
Cash flow hedge reserve	**(19)**
Deferred tax assets	**(19)**
Receivables from affiliated insurance group	**-**
Total Common Equity Tier 1 capital	**1,636**
Additional Tier 1 capital	
Perpetual capital bonds[3]	**150**
Total Additional Tier 1 capital	**150**
Total Tier 1 capital	**1,786**
Tier 2 capital	
Subordinated notes[3]	**195**
Total Tier 2 capital	**195**
Total capital	**1,981**

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

[2] Includes cash flow hedge reserve of $19m. The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of foreign exchange and interest rate derivative contracts related to hedged forecasted transactions that have not yet occurred. The cash flow hedge reserve is not eligible for inclusion in capital under BS2A 7 (3)(c).

[3] Perpetual capital bonds and subordinated notes are classified as debt of the Banking Group for financial reporting purposes.

Capital adequacy and regulatory liquidity ratios continued

On-balance sheet credit risk exposures

	The Banking Group			
	30/06/21			
Dollars in millions	Total exposure	Risk weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
On-balance sheet exposures				
Cash and gold bullion	51	0%	-	-
Sovereigns and central banks	1,326	0%	-	-
Multilateral development banks and other international organisations	456	0%	-	-
Public sector entities	25	20%	5	-
	-	100%	-	-
Banks	193	20%	39	3
	217	50%	109	9
Corporate	276	20%	55	4
	18	50%	9	1
	2,324	100%	2,324	186
Residential mortgages not past due				
Non-property investment residential mortgage loans				
<= 80% loan-to-value ratio ("**LVR**")	12,424	35%	4,348	348
80 <= 90% LVR	1,264	50%	632	51
90 <= 100% LVR	46	75%	35	3
> 100% LVR	168	100%	168	13
Non-property investment residential mortgage loans – First Home loans and lenders mortgage insured loans				
<= 80% LVR	311	35%	109	9
80 <= 90% LVR	246	35%	86	7
90 <= 100% LVR	58	50%	29	2
Property investment residential mortgage loans				
<= 80% LVR	7,653	40%	3,061	245
80 <= 90% LVR	86	70%	60	5
90 <= 100% LVR	42	90%	38	3
> 100% LVR	47	100%	47	4
Property investment residential mortgage loans – lenders mortgage insured loans				
<= 80% LVR	25	40%	10	1
80 <= 90% LVR	1	50%	1	-
Impaired assets	-	100%	-	-
Past due residential mortgages > 90 days	10	100%	10	1
	-	35%	-	-
Other past due assets	4	150%	6	-
Non-risk-weighted assets	297	0%	-	-
All other equity holdings not deducted from capital	-	400%	1	-
Other assets	661	100%	661	53
Total on-balance sheet exposures	**28,229**		**11,843**	**948**

Capital adequacy and regulatory liquidity ratios continued

Off-balance-sheet exposures and market-related contracts

	The Banking Group 30/06/21					
Dollars in millions	Total exposure	Credit conversion factor	Credit equivalent amount	Average risk weighting	Risk-weighted exposure	Minimum Pillar I capital requirement
Direct credit substitute	**45**	**100%**	**45**	**99%**	**45**	**4**
Performance-related contingency	**14**	**50%**	**7**	**100%**	**7**	**1**
Other commitments where original maturity is more than one year	**3,047**	**50%**	**1,524**	**51%**	**777**	**62**
Other commitments where original maturity is less than or equal to one year	**292**	**20%**	**58**	**86%**	**50**	**4**
Other commitments that cancel automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	**915**	**0%**	**-**	**0%**	**-**	**-**
Market-related contracts:[1]						
a) Foreign exchange contracts	**1,880**	**n/a**	**103**	**48%**	**49**	**4**
b) Interest rate contracts	**18,173**	**n/a**	**241**	**47%**	**113**	**9**
c) Credit Valuation Adjustment		**n/a**			**87**	**7**
Total off-balance-sheet exposures	**24,366**		**1,978**		**1,128**	**91**

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

Total exposure amounts in the table above are disclosed net of credit impairment provisions.

Residential mortgages by loan-to-value ratio

	The Banking Group 30/06/21		
Dollars in millions	On-balance sheet	Off-balance sheet	Total
LVR 0% – 80%	**20,423**	**1,127**	**21,550**
LVR 80% – 90%	**1,597**	**59**	**1,656**
LVR 90% +	**361**	**48**	**409**
Total	**22,381**	**1,234**	**23,615**

The LVR classification above is calculated in compliance with the Order. The off-balance sheet amounts disclosed in the table above are credit equivalent amounts disclosed net of the relevant credit conversion factor.

At 30 June 2021, of the loans with an LVR greater than 80%, $305m (30 June 2020: $360m) relates to loans with mortgage insurance or ‘First Home’ loans, whose credit risk is mitigated by the New Zealand Crown (via underwriting by Housing New Zealand Corporation).

Capital adequacy and regulatory liquidity ratios continued

Reconciliation of mortgage-related amounts

Dollars in millions	The Banking Group 30/06/21
On-balance sheet exposures	
Residential mortgages total on-balance sheet exposures	**22,381**
Provision for credit impairment	**19**
Deferred arrangement fees	**81**
Gross residential mortgage loans per asset quality (Note 10)	**22,481**
Residentially secured lending included within 'Other term lending'	**(976)**
Gross term loans – housing per loans and advances (Note 8)	**21,505**
Off-balance sheet exposures	
Residential mortgages total off-balance sheet exposures	**1,234**
Adjustment for credit conversion factor	**1,298**
Gross residential mortgages per asset quality (Note 10)	**2,532**

The residential mortgages above includes balances for the purpose of investment in residential property and owner-occupied housing.

Credit risk mitigation

	The Banking Group 30/06/21			
Dollars in millions	Total value of on- and off-balance-sheet exposures covered by eligible collateral (after haircutting)	Total value of on- and off-balance-sheet exposures covered by guarantees or credit derivatives	Risk-weighted exposure	Minimum Pillar I capital requirement
Bank	**(19,492)**	**-**	**(165)**	**(13)**
	(19,492)	**-**	**(165)**	**(13)**

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

Operational risk

	The Banking Group 30/06/21	
Dollars in millions	Implied risk-weighted exposure	Total operational risk capital requirement
Operational risk	**1,603**	**128**

Capital adequacy and regulatory liquidity ratios continued

Market risk

	The Banking Group 30/06/21			
	Implied risk-weighted exposure		Aggregate capital charge	
Dollars in millions	End of period	Peak end-of-day	End of period	Peak end-of-day
Interest rate risk	**595**	**663**	**48**	**53**
- of which relates to trading book	**11**	**26**	**1**	**2**
Foreign currency risk	**1**	**7**	**-**	**1**
Equity risk	**-**	**-**	**-**	**-**

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

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

Total capital requirements

	The Banking Group 30/06/21		
Dollars in millions	Total exposure after credit risk mitigation	Risk-weighted exposure or implied risk-weighted exposure	Total capital requirement
Total credit risk plus equity	**33,103**	**12,806**	**1,026**
Operational risk	**n/a**	**1,603**	**128**
Market risk	**n/a**	**596**	**48**
Total Pillar I risk	**n/a**	**15,005**	**1,202**

Other material risks (Pillar II)

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

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

For these other material risks the Bank has made an internal capital allocation of $58m (30 June 2020: $54m).

Regulatory liquidity ratios

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

	Three months ended 30/06/21	Three months ended 31/03/21
Average one-week mismatch ratio	**7.4%**	7.0%
Average one-month mismatch ratio	**7.2%**	6.6%
Average core funding ratio	**89.3%**	89.8%

Conditions of registration

Under section 74 of the Reserve Bank of New Zealand Act 1989, Kiwibank Limited is subject to the following conditions of registration set by the Reserve Bank of New Zealand (“**RBNZ**”), which were applicable as at 30 June 2021:

Conditions of registration for Kiwibank Limited

These conditions apply on and after 29 April 2021, except as provided otherwise.

The registration of Kiwibank Limited (the “Bank”) as a registered bank is subject to the following conditions.

1. That:

   a) the Total capital ratio of the Banking Group is not less than 8%;
   b) the Tier 1 capital ratio of the Banking Group is not less than 6%;
   c) the Common Equity Tier 1 capital ratio of the Banking Group is not less than 4.5%;
   d) the Total capital of the Banking Group is not less than $30m;
   e) the Bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the RBNZ; and
   f) the Bank meets the requirements of Part 3 of the RBNZ document entitled “Application requirements for capital recognition or repayment and notification requirements in respect of capital” (BS16) dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration:

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

1A. That:

   a) the Bank has an internal capital adequacy assessment process (“**ICAAP**”) that accords with the requirements set out in the document entitled “Guidelines on a bank’s internal capital adequacy assessment process (‘ICAAP’)” (BS12) dated December 2007;
   b) under its ICAAP, the Bank identifies and measures its “other material risks” defined as all material risks of the Banking Group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015; and
   c) the Bank determines an internal capital allocation for each identified and measured “other material risk”.

1B. That, if the buffer ratio of the Banking Group is 2.5% or less, the Bank must:

   a) according to the following table, limit the aggregate distributions of the Bank’s earnings to the percentage limit on distributions that corresponds to the Banking Group’s buffer ratio:

The Banking Group’s buffer ratio	Percentage limit on distributions of the Bank’s earnings
0% – 0.625%	0%
0.625% – 1.25%	20%
1.25% – 1.875%	40%
1.875% – 2.5%	50%

   b) prepare a capital plan to restore the Banking Group’s buffer ratio to above 2.5% within any timeframe determined by the RBNZ for restoring the buffer ratio; and
   c) have the capital plan approved by the RBNZ.

   For the purposes of this condition of registration:

   — “buffer ratio”, “distributions” and “earnings” have the same meaning as in Part 3 of the RBNZ’s document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015.

Conditions of registration continued

1C. That, if the buffer ratio of the Banking Group is more than 2.5%, the Bank must limit aggregate distributions, other than discretionary payments payable to holders of Additional Tier 1 capital instruments, to no more than 50% of the Bank's earnings.

For the purposes of this condition of registration:

— an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8.2(a) or (c) of the RBNZ's document entitled "Capital Adequacy Framework (Standardised Approach" (BS2A) dated November 2015;
— "buffer ratio", "distributions" and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015;
— the Bank must not make any individual dividend payment contributing to aggregate distributions for a financial year until it has completed its interim financial accounts for the first six months of its financial year or its annual financial accounts for its full financial year, and must not make any such dividend payment less than six months after any previous such dividend payment.

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

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

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

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

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

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

a) all amounts must relate to on-balance-sheet items only, and must comply with generally accepted accounting practice; and
b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration:

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

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

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

[1] This table uses the rating scales of Standard and Poor's, Moody's and Fitch.

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

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the RBNZ's document entitled "Connected Exposure Policy" (BS8) dated November 2015.

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

Conditions of registration continued

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

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

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

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer is made in respect of the Bank, unless:

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

8. That a person must not be appointed as chairperson of the board of the Bank, unless:

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

9. That the Bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

   a) the mandate of the committee must include ensuring the integrity of the Bank's financial controls, reporting systems and internal audit standards;
   b) the committee must have at least three members;
   c) every member of the committee must be a non-executive director of the Bank;
   d) the majority of the members of the committee must be independent; and
   e) the chairperson of the committee must be independent and must not be the chairperson of the Bank.

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

10. That a substantial proportion of the Bank's business is conducted in and from New Zealand.

11. That the Bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the Bank that are carried out by a person other than the Bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the Bank or of a service provider to the Bank, the following outcomes:

    a) that the Bank's clearing and settlement obligations due on a day can be met on that day;
    b) that the Bank's financial risk positions on a day can be identified on that day;
    c) that the Bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
    d) that the Bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

    This condition ceases to apply in respect of an existing outsourcing arrangement on the earlier of either 1 October 2023 or when the existing outsourcing arrangement becomes compliant with condition 21, from which point in time condition 21 will apply to that outsourcing arrangement.

    For the purposes of this condition of registration:

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

12. That:

    a) the business and affairs of the Bank are managed by, or under the direction or supervision of, the board of the Bank;
    b) the employment contract of the chief executive officer of the Bank or person in an equivalent position (together "CEO") is with the Bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the Bank; and
    c) all staff employed by the Bank shall have their remuneration determined by (or under the delegated authority of) the board or the CEO of the Bank and be accountable (directly or indirectly) to the CEO of the Bank.

Conditions of registration continued

13. Before and on 30 April 2021, that the Banking Group complies with the following quantitative requirements for liquidity-risk management:

    a) the one-week mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
    b) the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
    c) the one-year core funding ratio of the Banking Group is not less than 50% at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated January 2018 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated October 2018.

13A. On and or after 1 May 2021, that the Banking Group complies with the following quantitative requirements for liquidity risk management:

    a) the one-week mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
    b) the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day; and
    c) the one-year core funding ratio of the Banking Group is not less than 50% at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the RBNZ's documents entitled "Liquidity Policy" (BS13) dated May 2021 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated May 2021.

14. That the Bank has an internal framework for liquidity risk management that is adequate in the Bank's view for managing the Bank's liquidity risk at a prudent level, and that, in particular:

    a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
    b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
    c) identifies the principal methods that the Bank will use for measuring, monitoring and controlling liquidity risk; and
    d) considers the material sources of stress that the Bank might face, and prepares the Bank to manage stress through a contingency funding plan.

15. That no more than 10% of total assets may be beneficially owned by a SPV.

    For the purposes of this condition:

    — "total assets" means all assets of the Banking Group plus any assets held by any SPV that are not included in the Banking Group's assets;
    — "SPV" means a person
        a) to whom any member of the Banking Group has sold, assigned, or otherwise transferred any asset;
        b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
        c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the Banking Group under a covered bond;
    — "covered bond" means a debt security issued by any member of the Banking Group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

16. That:

    a) no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:

        i) the Bank has notified the RBNZ in writing of the intended acquisition or business combination and at least 10 working days have passed; and
        ii) at the time of notifying the RBNZ of the intended acquisition or business combination, the Bank provided the RBNZ with the information required under the RBNZ's Banking Supervision Handbook document entitled "Significant Acquisitions Policy" (BS15) dated December 2011; and

    b) no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold, unless:

        i) the Bank has notified the RBNZ in writing of the intended acquisition or business combination;
        ii) at the time of notifying the RBNZ of the intended acquisition or business combination, the Bank provided the RBNZ with the information required under the RBNZ's Banking Supervision Handbook document entitled "Significant Acquisitions Policy" (BS15) dated December 2011; and
        iii) the RBNZ has given the Bank a notice of non-objection to the significant acquisition or business combination.

    For the purposes of this condition of registration, "qualifying acquisition or business combination", "notification threshold" and "non-objection threshold" have the same meaning as in the RBNZ's Banking Supervision Handbook document entitled "Significant Acquisitions Policy" (BS15) dated December 2011.

Conditions of registration continued

17. That the Bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the RBNZ, the Bank can:

    a) close promptly at any time of the day and on any day of the week and that effective on the appointment of the statutory manager:
       i) all liabilities are frozen in full; and
       ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;
    b) apply a *de minimis* to relevant customer accounts;
    c) apply a partial freeze to the customer liability account balances;
    d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;
    e) maintain a full freeze on liabilities not pre-positioned for Open Bank Resolution; and
    f) reinstate customers' access to some or all of their residual frozen funds.

    For the purposes of this condition of registration, "de minimis", "partial freeze", "customer liability account" and "frozen and unfrozen funds" have the same meaning as in the RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

18. That the Bank has an Implementation Plan that:

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

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the RBNZ document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

19. That the Bank has a compendium of liabilities that:

    a) at the product-class level, lists all liabilities, indicating which are:
       i) pre-positioned for Open Bank Resolution; and
       ii) not pre-positioned for Open Bank Resolution;
    b) is agreed by the RBNZ; and
    c) if the RBNZ's agreement is conditional, meets the RBNZ's conditions.

    For the purposes of this condition of registration, "compendium of liabilities" and "pre-positioned and non-pre-positioned liabilities" have the same meaning as in the RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

20. That, on an annual basis, the Bank tests all the component parts of its Open Bank Resolution solution that demonstrates the Bank's prepositioning for Open Bank Resolution as specified in the Bank's Implementation Plan.

    For the purposes of this condition of registration, "Implementation Plan" has the same meaning as in the RBNZ's document entitled "Open Bank Resolution (OBR) Pre-positioning Requirements Policy" (BS17) dated September 2013.

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

22. That, for a loan-to-valuation measurement period ending on or before 30 June 2021, the total of the Bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with loan-to-valuation ratio of more than 70% must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

23. That, for a loan-to-valuation period ending on or after 31 July 2021, the total of the Bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

24. That, for a loan-to-valuation period, the total of the Bank's qualifying new mortgage lending amount in respect of non-property-investment residential mortgage loans with loan-to-valuation ratio of more than 80% must not exceed 20% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

25. That the Bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

    In these conditions of registration:

    — "Banking Group" means Kiwibank Limited (as a reporting entity) and all other entities included in the Group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act; and
    — "generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

Conditions of registration continued

In conditions of registration 22 to 25:

— "loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of property investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non-property-investment residential mortgage loans"; and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) date January 2019; and

— "loan-to-valuation measurement period" means:

i) the three-calendar-month period ending on the last day of May 2021; and
ii) thereafter a period of three calendar months ending on the last day of the third calendar month, the first of which ends on the last day of June 2021.

Non-compliance with conditions of registration

For completeness, it is noted that the Bank continues to discuss with the Reserve Bank issues arising from:

- the independent review of compliance with its liquidity conditions of registration (Conditions of Registration 13 and 14); and
- the Reserve Bank's findings relevant to Kiwibank from its industry thematic review of compliance with its Liquidity Policy (BS13).

Any disclosures that may be required from either review would be reported in the Disclosure Statement for the period ending 31 December 2021.

Changes to conditions of registration

The RBNZ issued revisions to the conditions of registration effective for Kiwibank Limited on and after 1 December 2020, 1 March 2021, 29 April 2021, 1 May 2021 and 1 July 2021.

The new conditions on and after 1 December 2020:

- corrected an editorial error in condition 11 to reference condition 21 instead of condition 24.

The new conditions on and after 1 March 2021:

- restricted the Bank's new mortgage lending on property-investment residential mortgage loans with a loan-to-value ratio of more than 70% to 5% of the total qualifying new lending for a measurement period ending on or before 30 June 2021; and further restricted this lending by decreasing the loan-to-value ratio from 70% to 60% for a measurement period ending on or after 31 July 2021; and
- restricted the Bank's new mortgage lending on non-property-investment residential mortgage loans with a loan-to-value ratio of more than 80% to 20% of the total qualifying new lending.

The new conditions on and after 29 April 2021:

- amended the restrictions on payments of dividends to allow the Bank to pay dividends not exceeding 50% of net profit after tax in the most recently completed financial year where the Banking Group's buffer ratio is more than 2.5%.

The new conditions on and after 1 May 2021:

- added new condition 13A, which requires the Banking Group to calculate liquidity ratios in accordance with the Liquidity Policy (BS13) dated May 2021 and Liquidity Policy Annex: Liquid Assets (BS13A) dated May 2021.

The new conditions on and after 1 July 2021:

- amended the definitions of "total capital ratio", "Tier 2 capital instrument", and "total capital".

Independent auditor's report

To the readers of Kiwibank Limited's financial statements for the year ended 30 June 2021

This report is for the Banking Group, comprising Kiwibank Limited (the 'Bank'), its New Zealand domiciled subsidiaries and the other entities it controlled at 30 June 2021 or from time to time during the financial year.

The Auditor-General is the auditor of Kiwibank Limited (the 'Bank') and the Banking Group (the 'Banking Group'). The Auditor-General has appointed me, Jonathan Freeman, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Banking Group on his behalf.

This report includes:

- our audit opinion on the financial statements prepared:
  - in accordance with Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'); and
  - in compliance with generally accepted accounting practice in New Zealand in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').

  The financial statements comprise:
  - the balance sheet as at 30 June 2021;
  - the income statement for the year then ended;
  - the statement of comprehensive income for the year then ended;
  - the statement of changes in equity for the year then ended;
  - the cash flow statement for the year then ended; and
  - the notes to the financial statements, which include general accounting policies.
- our audit opinion on the supplementary information for the year ended 30 June 2021 prepared in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order;
- our audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- our review conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements prepared in accordance with Schedule 9 of the Order.

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

Our audit opinion

In our opinion:

- The Banking Group's financial statements (excluding supplementary information disclosed in accordance with Schedules 4, 7, 9, 13, 14, 15, and 17 of the Order and within notes 10, 11, 12, 31, and 33):
  - (i) comply with generally accepted accounting practice in New Zealand;
  - (ii) comply with NZ IFRS and IFRS; and

(iii) give a true and fair view of the financial position of the Banking Group as at 30 June 2021, and its financial performance and cash flows for the year then ended.

- The supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and included in the balance sheet and notes 10, 11, 12, 31, and 33 of the financial statements and within the capital adequacy and regulatory liquidity ratios disclosures on page 110 in relation to the reconciliation of mortgage-related amounts:
  (i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  (ii) is in accordance with the books and records of the Banking Group; and
  (iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Basis for audit opinion

We conducted our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the Professional and Ethical Standards and the International Standards on Auditing (New Zealand) issued by the New Zealand Auditing and Assurance Standards Board. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)* section of our report.

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

Independence

We are independent of the Banking Group in accordance with the Auditor-General's Auditing Standards, which incorporate Professional and Ethical Standard 1: *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

In addition to the audit we have carried out engagements in the areas of agreed-upon procedures, register compliance assurance and compliance assurance with certain matters in trust deeds associated with entities within the Banking Group which are compatible with those independence requirements. Certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. Other than the audit, these engagements, and partners and employees dealing with the Banking Group in the ordinary course of trading activities of the Banking Group, we have no relationship with or interests in the Banking Group.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How our audit addressed the Key Audit Matters
Provision for credit impairment on loans and advances As detailed in Note 9 to the financial statements, the Banking Group has recognised a provision for credit impairment of $62 million (30 June 2020: $86 million) which includes both individually assessed and collectively assessed provisions. The Banking Group recognises credit impairment provisions for expected credit losses (ECL) which are probability weighted and determined by evaluating a range of possible outcomes, taking into account the time value of money, past events, current conditions and forecast of future economic conditions. We considered this a key audit matter due to the subjective judgements and assumptions made by the Banking Group in determining the timing of recognition and the level of provision for ECL and the nature and extent of audit effort needed. The key judgements and assumptions in determining ECL include: ● modelling inputs for probability of default (PD), exposure at default (EAD), loss given default (LGD) attrition rates and product maturity profiles; ● the criteria under which exposures move between IFRS stages, particularly when moving between fully performing (stage 1) and demonstrating a significant increase in credit risk (stage 2); ● the macroeconomic inputs used within each of the economic scenarios; ● the weightings given to each economic scenario; and	We obtained an understanding of the controls implemented by management over the ECL impairment models and assessed whether they were appropriately designed and implemented. We tested the operating effectiveness of certain controls throughout the year on a sample basis. We, along with PwC actuarial experts, performed the following procedures, amongst others: ● Assessed the ECL model methodology and approach taken by the Banking Group against the requirements of accounting standards and the results of model monitoring performed; ● Considered the Banking Group's judgements, including the reasonableness of forward-looking information incorporated into the ECL models, by assessing the forecasts, assumptions and probability weightings applied in multiple macroeconomic scenarios against current market conditions and other available evidence; ● Tested the completeness and accuracy of a sample of critical data elements to the ECL models, agreeing them to relevant source and underlying model documentation; ● Reviewed the reasonableness of the credit risk grades that were allocated to the borrower; ● Performed a risk assessment over the movement of individually assessed credit impaired assets and considered the reasonableness of these movements; ● Recalculated the ECL model results for a sample of loans and advances;

Key Audit Matters	How our audit addressed the Key Audit Matters
• any overlays required to estimate impairments due to the potential loss events that could occur as well as loss events that have occurred but where those impacts have not yet been incorporated into the ECL models. The nature and extent of audit effort involved the use of professionals with specialised skills and knowledge and testing of critical data elements used in the models. Loans and advances that exceed specific thresholds are individually assessed by management. If an individually assessed loan and advance is not impaired, it is then included in a group of loans and advances with similar risk characteristics and, along with those loans and advances below the specific thresholds referred to above, is collectively assessed on a portfolio basis using the ECL models developed by management. The Banking Group's models are reliant on large volumes of data as well as a number of estimates including the impact of multiple economic scenarios, definition of significant increase in credit risk, and other assumptions. In the prior year, management established a COVID-19 model overlay due to potential loss events that could occur as well as loss events that have occurred due to COVID-19. In the current year, the expected impact of COVID-19 on borrower default rates and economic outlook did not materialise in the way that was forecasted and the Banking Group has subsequently released the COVID-19 overlays and has changed the weightings applied to multiple macroeconomic scenarios. Refer to Note 9 to the financial statements which explains the critical accounting estimates and judgements in determining the credit impairment losses of loans and advances.	• For overlays to the modelled output, assessed the reasonableness of the judgements; • Performed a peer bank comparison and considered whether, with the inclusion of the overlays, the overall collective allowances for impairment sit within a range of acceptable outcomes; and • Considered the impact of events occurring subsequent to balance date on the ECL. We also assessed the appropriateness of the Banking Group's disclosures against the requirements of NZ IFRS and IFRS.

Key Audit Matters	How our audit addressed the Key Audit Matters
Operation of Information Technology (IT) systems and controls The Banking Group's operations and financial reporting processes are heavily reliant on IT systems, including automated processes and controls over the processing and recording of significant volumes of transactions. IT systems and controls is a key audit matter as they impact the financial recording and reporting of transactions and our audit approach could significantly differ depending on the effective operation of the Banking Group's IT controls. In considering the complexity of the Banking Group's processes and the design of the internal control environment, there are certain areas of the audit where we seek to place reliance on automated controls and reports. The effective operation of these areas is dependent on the Banking Group's IT General Control (ITGC) environment. This includes: ● change management internal controls which are important because they help ensure that changes to applications and data are authorised and made appropriately; and ● user access controls which are important to help ensure staff have appropriate access to IT systems and that access is monitored.	For significant financial statement transactions and balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those transactions and balances. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key controls that support the continued integrity of the IT systems relevant to financial reporting. Our procedures over ITGCs focused on user access and change management and we also carried out tests, on a sample basis, of system functionality that was key to our audit approach. Where we identified deficiencies in the design or operating effectiveness of those key controls, we performed additional or alternative audit procedures and communicated the deficiencies to management and those charged with governance.

Our audit approach

Overview

The overall Banking Group materiality was $7.5 million which represents approximately 5% of adjusted profit before taxation for the year ended 30 June 2021.

We chose adjusted profit before taxation as the benchmark because, in our view, it is the benchmark against which the performance of the Banking Group is most commonly measured by readers and is a generally accepted benchmark. We have derived adjusted profit before taxation by removing the significant one-off impact of the release of the COVID-19 credit impairment overlay of $19.8 million.

Full scope audits were performed for four of five entities in the Banking Group based on their financial significance. Specified audit procedures and analytical review procedures were performed on the remaining entity.

As reported above, we have two key audit matters, being:

- Provision for credit impairment on loans and advances
- Operation of Information Technology (IT) systems and controls

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality
The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance about whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Banking Group materiality for the financial statements as a whole as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate, on the financial statements as a whole.

How we tailored our group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Banking Group, the IT systems, accounting processes and controls, and the industry in which the Banking Group operates.

The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).

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

The Directors of the Bank (the 'Directors') are responsible, on behalf of the Bank, for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order included on pages 1 to 7 and on pages 112 to 117.

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

In connection with our audit of the financial statements and supplementary information, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the financial statements in accordance with Clause 24 of the Order, NZ IFRS and IFRS and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

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

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 15 and 17 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Auditor-General’s Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of readers taken on the basis of these financial statements.

As part of an audit in accordance with the Auditor-General’s Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Banking Group’s internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the use of the going concern basis of accounting by the Directors and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Banking Group’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the Banking Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Banking Group to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the Banking Group audit. We remain solely responsible for our opinion.

We communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during the audit.

We also provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Our responsibilities arise from the Public Audit Act 2001.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111) for the year ended 30 June 2021:

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

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

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

We have examined the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 9 of the Order as disclosed on pages 105 to 111 of the Disclosure Statement of the Banking Group for the year ended 30 June 2021.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

This conclusion is to be read in the context of what we say in the remainder of this report.

Basis for our conclusion

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410).

Our responsibilities under this standard are further described in the *Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements* section of our report.

Responsibilities of the Directors for the supplementary information relating to capital adequacy and regulatory liquidity requirements

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements that is free from material misstatement, whether due to fraud or error.

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

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111 of the Disclosure Statement, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111 of the Disclosure Statement in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Accordingly, we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 105 to 111 of the Disclosure Statement.

Jonathan Freeman
On behalf of the Auditor-General

PricewaterhouseCoopers

Wellington, New Zealand
25 August 2021

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