Disclosure Statement

For the six months ended 31 December 2018

Kiwibank.

Number 68

Contents

General matters

Details of incorporation

Kiwibank Limited ("**Kiwibank**") 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, Kiwibank was registered as a bank under the Reserve Bank of New Zealand Act 1989 (the "**RBNZ Act**") 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.

This Disclosure Statement has been issued by Kiwibank for the six months ended 31 December 2018, in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "**Order**"). Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

In this Disclosure Statement, "**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.

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.

Other material matters

The Board of Directors of Kiwibank (the "**Board**") are of the opinion that there are no other 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.

Credit ratings

Kiwibank has the following credit ratings applicable to its long term unsecured obligations payable in New Zealand, in New Zealand dollars:

Rating agency	Current credit rating	Rating outlook
S&P Global Ratings ("**S&P**")	A	Outlook Positive
Moody's Investors Service ("**Moody's**")	A1	Outlook Stable
Fitch Ratings ("**Fitch**")	AA	Outlook Stable

General matters continued

Conditions of registration

Changes in conditions of registration

The RBNZ has issued revised conditions of registration which are effective from 1 October 2018. The new conditions refer to a revised version of the RBNZ's *BS13A: Liquidity Policy Annex* which includes minor technical amendments.

The RBNZ issued a further revision to conditions of registration effective from 1 January 2019. The new conditions refer to a revised version of *BS19: Framework for Restrictions on High-LVR Residential Mortgage Lending* which amends some of the terms and conditions relating to the LVR conditions of registration.

Directorate

David James Walsh, previously an alternate director, was appointed as a director on 31 August 2018.

Carol Anne Campbell resigned as a director on 31 August 2018 and was subsequently re-appointed as a director on 20 November 2018.

Deborah Jane Taylor resigned as a director on 31 October 2018.

There have been no other changes in the Board for the six months ended 31 December 2018.

Responsible persons

Susan Carrel Macken and Alistair Bruce Ryan have been authorised in writing to sign this Disclosure Statement in accordance with Section 82 of the RBNZ Act, on behalf of the directors, being:

Susan Carrel Macken
Kevin Mark Malloy
Ian Cameron Blair
Scott John Pickering
Michael Charles John O'Donnell
Alistair Bruce Ryan
Carol Anne Campbell
David James Walsh

Auditor

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

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 New Zealand Post Limited (the "**NZP Guarantee**").

Further details on the NZP Guarantee can be obtained by referring to Kiwibank's Disclosure Statement for the year ended 30 June 2018 which is available at www.kiwibank.co.nz.

On 31 October 2016, New Zealand Post Limited ("**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.

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.

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 $755m as calculated from NZP's most recent publicly available audited financial statements for the year ended 30 June 2018 and as disclosed in the Director's Report in the NZ Post Group Finance Limited Annual Report for the year ended 30 June 2018. There were no modifications in the audit report accompanying the Annual Report.

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.

Covered Bond Guarantee

Certain debt securities ("**Covered Bonds**") issued by Kiwibank are guaranteed by Kiwi Covered Bond Trustee Limited (the "**Covered Bond Guarantor**"), solely in its capacity as Trustee of Kiwibank Covered Bond Trust. The Covered Bond Guarantor has guaranteed the payment of interest and principal of Covered Bonds, pursuant to a guarantee which is secured over a pool of assets. The Covered Bond Guarantor's address for service is Level 9, 34 Shortland Street, Auckland, New Zealand. The Covered Bond Guarantor is not a member of the Banking Group. The Covered Bonds have been assigned a long term rating of Aaa and AAA by Moody's Investors Service and Fitch Ratings respectively.

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 period ended 31 December 2018:
    i. Kiwibank has complied 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.

Signed by Susan Carrel Macken and Alistair Bruce Ryan as directors and responsible persons on behalf of all the directors listed in the Directorate of this Disclosure Statement:

19 February 2019

Interim financial statements

Income statement

For the six months ended 31 December 2018

Dollars in millions	Note	Unaudited 6 months ended 31/12/18	Unaudited 6 months ended 31/12/17	Audited year ended 30/06/18
Interest income		462	438	879
Interest expense		(239)	(240)	(468)
Net interest income		223	198	411
Net gains on financial instruments at fair value	2	2	5	9
Gross fee and other income		97	106	211
Direct fee expenses		(49)	(46)	(92)
Net fee and other income		48	60	119
Total operating income		273	263	539
Operating expenses		(183)	(197)	(373)
Profit before impairment and taxation		90	66	166
Credit impairment losses	4	(4)	(1)	(1)
Other impairment losses		-	(11)	(11)
Profit before taxation		86	54	154
Income tax expense		(24)	(12)	(39)
Profit after taxation		62	42	115

Statement of comprehensive income

For the six months ended 31 December 2018

Dollars in millions	Unaudited 6 months ended 31/12/18	Unaudited 6 months ended 31/12/17	Audited year ended 30/06/18
Profit after taxation	62	42	115
Other comprehensive income			
Net gain/(loss) from changes in reserves that may subsequently be reclassified to profit or loss			
- Fair value reserve (net of tax)	2	1	-
- Cash flow hedge reserve (net of tax)	-	2	3
Other comprehensive income for the period/year	2	3	3
Total comprehensive income for the period/year	64	45	118

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Income Statement and Statement of Comprehensive Income. "Impairment (losses)/reversals on loans and advances" has been renamed "credit impairment (losses)/reversals". In relation to changes in reserves, "Available-for-sale reserve" has been renamed "Fair value reserve". See note 23 for more details of the related changes in accounting policies and impact of adoption.

Interim financial statements continued

Statement of changes in equity

For the six months ended 31 December 2018

Dollars in millions	Fully Paid Ordinary Shares	Retained Earnings	Fair Value Reserve	Cash Flow Hedge Reserve	Total Shareholder's Equity
Balance at 1 July 2017	737	651	5	(13)	1,380
Unaudited 6 months ended 31 December 2017					
Unaudited profit for the period	-	42	-	-	42
Other comprehensive income					
Movement in fair value of investment securities (net of tax)	-	-	1	-	1
Cash flow hedges (net of tax)	-	-	-	2	2
Total other comprehensive income	-	-	1	2	3
Total comprehensive income	-	42	1	2	45
Transactions with owners					
Distributions to holder of perpetual capital	-	(5)	-	-	(5)
Unaudited balance at 31 December 2017	737	688	6	(11)	1,420
Audited year ended 30 June 2018					
Audited profit for the year	-	115	-	-	115
Other comprehensive income					
Movement in fair value of investment securities (net of tax)	-	-	-	-	-
Cash flow hedges (net of tax)	-	-	-	3	3
Total other comprehensive income	-	-	-	3	3
Total comprehensive income	-	115	-	3	118
Transactions with owners					
Distributions to holder of perpetual capital	-	(11)	-	-	(11)
Audited balance at 30 June 2018	737	755	5	(10)	1,487
Balance adjusted for adoption of NZ IFRS 9 and NZ IFRS 15	-	(4)	-	-	(4)
Opening balance as at 1 July 2018	737	751	5	(10)	1,483
Unaudited 6 months ended 31 December 2018					
Unaudited profit for the period	-	62	-	-	62
Other comprehensive income					
Movement in fair value of investment securities (net of tax)	-	-	2	-	2
Cash flow hedges (net of tax)	-	-	-	-	-
Total other comprehensive income	-	-	2	-	2
Total comprehensive income	-	62	2	-	64
Transactions with owners					
Dividends paid on ordinary shares	-	(14)	-	-	(14)
Distributions to holder of perpetual capital	-	(5)	-	-	(5)
Unaudited balance at 31 December 2018	737	794	7	(10)	1,528

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Statement of Changes in Equity. “Available-for-sale reserve” has been renamed “Fair value reserve” and “Available-for-sale financial assets” have been renamed “Investment securities”. See note 23 for more details of the related changes in accounting policies and impact of adoption.

Interim financial statements continued

Balance sheet

As at 31 December 2018

Dollars in millions	Note	Unaudited 31/12/18	Unaudited 31/12/17	Audited 30/06/18
Assets				
Cash and cash equivalents		447	463	447
Due from related parties	14	82	84	87
Due from other financial institutions	6	342	125	132
Investment securities		1,333	1,148	1,220
Derivative financial instruments		326	350	344
Loans and advances	3	19,316	18,027	18,304
Current tax asset		21	-	12
Deferred taxation		15	39	11
Property, plant and equipment		50	36	45
Intangible assets		81	84	78
Other assets		27	25	35
Total assets		22,040	20,381	20,715
Total interest earning and discount bearing assets		*21,394*	*19,720*	*20,074*
Liabilities				
Due to other financial institutions		150	117	128
Due to related parties	14	5	7	8
Derivative financial instruments		289	346	293
Deposits and other borrowings	7	17,430	15,960	16,173
Debt securities issued	8	2,253	2,170	2,265
Current tax liability		-	4	-
Contract liabilities		27	-	-
Other liabilities		105	102	107
Subordinated debt	9	253	255	254
Total liabilities		20,512	18,961	19,228
Total interest and discount bearing liabilities		*17,788*	*16,454*	*16,752*
Shareholder's equity				
Share capital		737	737	737
Reserves		791	683	750
Total shareholder's equity		1,528	1,420	1,487
Total liabilities and shareholder's equity		22,040	20,381	20,715

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 in the preparation of the Balance Sheet. “Available-for-sale assets” has been renamed “Investment securities”. See note 23 for more details of the related changes in accounting policies and impact of adoption.

Interim financial statements continued

Cash flow statement

For the six months ended 31 December 2018

Dollars in millions	Unaudited 6 months ended 31/12/18	Unaudited 6 months ended 31/12/17	Audited year ended 30/06/18
Cash flows from operating activities			
Interest received	478	453	915
Interest paid	(223)	(232)	(465)
Fees and other income received	119	103	202
Direct fee expenses paid	(48)	(46)	(92)
Operating expenses paid	(165)	(173)	(333)
Taxes paid	(35)	(22)	(38)
Net cash flows from operating activities before changes in operating assets and liabilities	126	83	189
Net changes in operating assets and liabilities			
(Increase)/decrease in investment securities	(111)	329	255
Increase in loans and advances	(1,026)	(232)	(536)
Decrease/(increase) in net amounts due from related parties	2	(9)	(5)
(Increase)/decrease in balances due from other financial institutions	(210)	103	96
Increase/(decrease) in deposits and other borrowing	1,240	(31)	185
Decrease in balances due to other financial institutions	22	58	69
Net cash flows provided by operating activities	43	301	253
Cash flows from investing activities			
Purchase of property, plant and equipment	(11)	(13)	(27)
Purchase of intangible assets	(13)	(10)	(19)
Net cash flows from investing activities	(24)	(23)	(46)
Cash flows from financing activities			
Decrease in debt securities issued	-	(127)	(65)
Repayment of subordinated debt	-	(150)	(150)
Dividends paid on ordinary shares	(14)	-	(11)
Distributions paid to holder of perpetual capital	(5)	(5)	-
Net cash flows from financing activities	(19)	(282)	(226)
(Decrease)/increase in cash and cash equivalents	-	(4)	(19)
Cash and cash equivalents at beginning of the period/year	447	464	464
Effect of exchange translation adjustments	-	3	2
Cash and cash equivalents at end of the period/year	447	463	447

From 1 July 2018, the Banking Group has applied NZ IFRS 9 and NZ IFRS 15 with no impact on the preparation of the Cash flow statement. "Available-for-sale assets" has been renamed "Investment securities". See note 23 for more details of the related changes in accounting policies and impact of adoption.

Notes to the interim financial statements

1. Summary of significant accounting policies

1.1 Reporting entity

These consolidated interim 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**").

1.2 Basis of preparation

These interim financial statements are for the Banking Group for the six months ended 31 December 2018 and have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand, as appropriate for for-profit entities. They comply with NZ IAS 34 *Interim Financial Reporting*, IAS 34 *Interim Financial Reporting* and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "**Order**"). These interim financial statements should be read in conjunction with the Banking Group's financial statements for the year ended 30 June 2018.

Measurement base

These interim financial statements are based on the general principles of historic cost accounting, modified by the application of fair value measurements for the following assets and liabilities:

- Derivative financial instruments – held at fair value through profit or loss
- Debt securities issued – commercial paper held at fair value through profit or loss
- Investment securities – held at fair value through other comprehensive income

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.

1.3 Accounting policies

The accounting policies adopted in the preparation of the interim financial statements are consistent with those followed in the preparation of the Banking Group's annual financial statements for the year ended 30 June 2018, except for the adoption of new standards and interpretations effective as of 1 July 2018.

The Banking Group has applied, for the first time, the following new standards and amendments:

- NZ IFRS 9: *Financial Instruments*
- NZ IFRS 15: *Revenue from Contracts with Customers*

The application of the above standards did not have a material effect on the financial results of the Banking Group and were adopted without restatement of comparative amounts. Note 23 includes a description of the nature and effect of the changes made in accounting policies due to the adoption of the above standards and includes a disclosure of the financial impact of adoption.

1.4 Basis of consolidation

The consolidated interim financial statements of the Banking Group comprise the interim financial statements of Kiwibank and its subsidiaries for the period ended 31 December 2018, using the acquisition method. Subsidiaries are entities that are controlled by Kiwibank.

1.5 Functional and presentation currency

The Banking Group's interim 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.

Notes to the interim financial statements continued

1. Summary of significant accounting policies continued

1.6 Comparative amounts

Certain amounts in the comparative information have been reclassified or amended to ensure consistency with the current period's presentation. Some name changes have been made as part of the adoption of NZ IFRS 9 and these changes are disclosed where relevant. More information about the impact of adoption of new accounting standards is disclosed in note 23.

2. Net gains on financial instruments at fair value

Dollars in millions	Unaudited 6 months ended 31/12/18	Unaudited 6 months ended 31/12/17	Audited year ended 30/06/18
Derivative financial instruments held for trading	(1)	1	1
Net ineffectiveness on qualifying fair value hedges	-	1	1
Cumulative gain transferred from fair value reserve	1	2	4
Cumulative loss transferred from cash flow hedge reserve	-	(1)	(1)
Net foreign exchange gains	2	2	4
Total net gains on financial instruments	2	5	9

Net ineffectiveness on qualifying cash flow hedges is $0.0m (31 December 2017: $0.0m; 30 June 2018: $0.0m). Net ineffectiveness on qualifying fair value hedges is $0.0m (31 December 2017: $0.7m; 30 June 2018: $0.7m).

From 1 July 2018, the Banking Group has applied NZ IFRS 9 in the calculation and disclosure of net gains on financial instruments at fair value. Comparative balances have not been restated. "Available-for-sale reserve" has been renamed "fair value reserve". See note 23 for more details of the related changes in accounting policies and impact of adoption.

3. Loans and advances

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Overdrafts	78	70	74
Credit card outstandings	407	408	385
Term loans - housing	17,071	15,898	16,186
Other term lending	1,632	1,557	1,550
Other lending	164	132	145
Gross loans and advances	19,352	18,065	18,340
Provision for credit impairment	(36)	(39)	(36)
Fair value hedge adjustments	-	1	-
Total net loans and advances	19,316	18,027	18,304
Current	1,291	1,295	1,268
Non-current	18,025	16,732	17,036

The table above presents gross loans and advances by type of product. Total gross residential mortgage loans at 31 December 2018 were $17,952m (31 December 2017: $16,797m, 30 June 2018: $17,068m). This includes *term loans – housing* and other residentially secured lending included within *other term lending*.

Notes to the interim financial statements continued

3. Loans and advances continued

From 1 July 2018, the Banking Group has applied NZ IFRS 9 in the calculation and disclosure of loans and advances. "Collective allowance for impairment losses" and "allowance for individually impaired assets" have been combined in to one new line "provision for credit impairment" in the table above. See note 23 for more details of the related changes in accounting policies and impact of adoption.

4. Asset quality

From 1 July 2018, the Banking Group has applied NZ IFRS 9 in the calculation of the provision for credit impairment and in the preparation of the asset quality note. This includes a change to a three-stage approach to measuring expected credit losses ("ECL") for financial assets that are not measured at fair value through profit or loss. See Note 23 for more details of the related changes in accounting policies and impact of adoption of NZ IFRS 9.

Credit impairment (losses)/reversals recognised in income statement

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Unaudited period ended 31 December 2018				
Collective impairment (losses)/reversals	2	(1)	(2)	(1)
Individual impairment (losses)/reversals	(3)	-	-	(3)
Total credit impairment (losses)/reversals per income statement	(1)	(1)	(2)	(4)
Audited year ended 30 June 2018				
Collective impairment (losses)/reversals	1	4	(2)	3
Individual impairment (losses)/reversals	(6)	1	1	(4)
Total credit impairment (losses)/reversals per income statement	(5)	5	(1)	(1)
Unaudited period ended 31 December 2017				
Collective impairment (losses)/reversals	-	1	(1)	-
Individual impairment (losses)/reversals	(3)	1	1	(1)
Total credit impairment (losses)/reversals per income statement	(3)	2	-	(1)

Summary of lending

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Unaudited as at 31 December 2018				
Neither past due nor impaired	406	17,852	956	19,214
Past due but not impaired	27	95	7	129
Impaired	1	5	3	9
Gross	434	17,952	966	19,352
Provision for credit impairment	(10)	(15)	(11)	(36)
Fair value hedge adjustments	-	-	-	-
Net loans and advances	424	17,937	955	19,316

Gross loans of $63.6m were recategorised from 'retail unsecured lending' to 'business exposures' during the year to date as the underlying exposures were to business counterparties.

Notes to the interim financial statements continued

4. Asset quality continued

Loans and advances past due but not impaired

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Unaudited as at 31 December 2018				
Past due less than 30 days	21	67	4	92
Past due 30 - 59 days	4	17	1	22
Past due 60 - 89 days	1	4	-	5
Past due 90 days or greater	1	7	2	10
Total past due but not impaired	27	95	7	129

Impaired assets

Dollars in millions	Retail unsecured lending	Residential mortgage loans	Business exposures	Total
Unaudited as at 31 December 2018				
Gross impaired				
Balance at beginning of the period	1	5	4	10
Transfers from performing	3	2	2	7
Transfers to performing	-	(1)	-	(1)
Asset realisations and loans repaid	-	(1)	(3)	(4)
Amounts written off	(3)	-	-	(3)
Balance at end of the period	1	5	3	9
Specific provision for credit impairment	(1)	(2)	(2)	(5)
Total net impaired assets	-	3	1	4

Notes to the interim financial statements continued

4. Asset quality continued

Movement in provision for credit impairment - retail unsecured lending exposures

Dollars in millions	Collective Provison (NZ IAS 39)	Collective Provision 12-months ECL Stage 1	Collective Provision Lifetime ECL Not Credit Impaired Stage 2	Collective Provision Lifetime ECL Credit Impaired Stage 3	Specific Provision Lifetime ECL Credit Impaired	Total
Unaudited as at 31 December 2018						
Retail unsecured lending						
Balance at beginning of the period	8	-	-	-	1	9
Adjustment upon adoption of NZ IFRS 9	(8)	5	6	-	-	3
Transfers between stages:						-
- Transferred to Stage 1	-	1	(1)	-	-	-
- Transferred to Stage 2	-	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-	-
- Transferred to specific provision	-	-	-	-	-	-
Charged / (credited) to income statement	-	(1)	(1)	-	3	1
Amounts written off	-	-	-	-	(3)	(3)
Recovery of amounts written off	-	-	-	-	-	-
Balance at end of period - retail unsecured lending	-	4	5	-	1	10

Impact of changes in gross carrying amount on ECL - retail unsecured lending exposures

An explanation of how significant changes in the gross carrying amount of financial assets for retail unsecured lending exposures during the year have contributed to changes in the provision for credit impairment is outlined below.

Overall, credit impairment provisions for retail unsecured lending exposures decreased a net $2m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- *Collective Provision 12-months ECL stage 1* - reduced $1m driven by a net decrease of $27m in gross balances. New lending of $23m (+$0.4m impact on ECL) was offset by repayments of $50m (-$0.3m impact on ECL). $8m of gross balances moved from stage 2 to stage 1 while $8m moved from stage 1 to stage 2 during the year to date.
- *Collective Provision Lifetime ECL Not Credit Impaired stage 2* – reduced $1m driven by a net decrease in gross balances of $4m. New lending of $8m (+$0.5m impact on ECL) was offset by repayments of $12m (-$0.7m impact on ECL). $8m of gross balances moved from stage 2 to stage 1 while $8m moved from stage 1 to stage 2 during the year to date.
- *Collective Provision Lifetime ECL Credit Impaired stage 3* – stable during the year to date with small transfers in and out from stage 1 and 2 offsetting each other.
- *Specific Provision Lifetime ECL Credit Impaired* – stable with no material movement in gross balances during the year to date.

Notes to the interim financial statements continued

4. Asset quality continued

Movement in provision for credit impairment – residential mortgage loan exposures

Dollars in millions	Collective Provison (NZ IAS 39)	Collective Provision 12-months ECL Stage 1	Collective Provision Lifetime ECL Not Credit Impaired Stage 2	Collective Provision Lifetime ECL Credit Impaired Stage 3	Specific Provision Lifetime ECL Credit Impaired	Total
Unaudited as at 31 December 2018						
Residential mortgage loans						
Balance at beginning of the period	15	-	-	-	2	17
Adjustment upon adoption of NZ IFRS 9	(15)	7	4	1	-	(3)
Transfers between stages:						-
- Transferred to Stage 1	-	1	(1)	-	-	-
- Transferred to Stage 2	-	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-	-
- Transferred to specific provision	-	-	-	-	-	-
Charged / (credited) to income statement	-	2	(1)	-	-	1
Amounts written off	-	-	-	-	-	-
Recovery of amounts written off	-	-	-	-	-	-
Balance at end of period - residential mortgage loar	-	9	3	1	2	15

Impact of changes in gross carrying amount on ECL – residential mortgage loans exposures

An explanation of how significant changes in the gross carrying amount of financial assets for residential mortgage loan exposures during the year have contributed to changes in the provision for credit impairment is outlined below.

Overall, credit impairment provisions for residential mortgage loan exposures increased a net $1m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- *Collective Provision 12-months ECL stage 1* - increased $2m driven by a net increase of $873m in gross balances. New lending of $2,470m (+$1.3m impact on ECL) was partially offset by repayments of $1,597m (-$0.5m impact on ECL). $11m of balances moved from stage 2 to stage 1 while $4m moved from stage 1 to stage 2 in the year to date.
- *Collective Provision Lifetime ECL Not Credit Impaired stage 2* – reduced $1m driven by transfers out of stage 2 and repayments. $11m of gross balances moved from stage 2 to stage 1 while $4m moved from stage 1 to stage 2 during the year to date.
- *Collective Provision Lifetime ECL Credit Impaired stage 3* – stable during the year to date with small transfers in and out from stage 1 and 2 offsetting each other. Stage 3 gross balances increased a net $2m in the year to date.
- *Specific Provision Lifetime ECL Credit Impaired* – stable with no material movement in gross balances during the year to date.

Notes to the interim financial statements continued

4. Asset quality continued

Movement in provision for credit impairment – business exposures

Dollars in millions	Collective Provison (NZ IAS 39)	Collective Provision 12-months ECL Stage 1	Collective Provision Lifetime ECL Not Credit Impaired Stage 2	Collective Provision Lifetime ECL Credit Impaired Stage 3	Specific Provision Lifetime ECL Credit Impaired	Total
Unaudited as at 31 December 2018						
Business						
Balance at beginning of the period	8	-	-	-	2	10
Adjustment upon adoption of NZ IFRS 9	(8)	4	2	1	-	(1)
Transfers between stages:						-
- Transferred to Stage 1	-	1	(1)	-	-	-
- Transferred to Stage 2	-	(1)	1	-	-	-
- Transferred to Stage 3	-	-	-	-	-	-
- Transferred to specific provision	-	-	-	-	-	-
Charged / (credited) to income statement	-	1	2	(1)	-	2
Amounts written off	-	-	-	-	-	-
Recovery of amounts written off	-	-	-	-	-	-
Balance at end of period - Business	-	5	4	-	2	11

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

An explanation of how significant changes in the gross carrying amount of financial assets for business exposures during the year have contributed to changes in the provision for credit impairment is outlined below.

Overall, credit impairment provisions for business exposures increased a net $2m after the adjustment to opening balances upon adoption of NZ IFRS 9.

- *Collective Provision 12-months ECL stage 1* - increased $1m driven by a net increase of $151m in gross balances. New lending of $247m (+$1m impact on ECL) was offset by repayments of $96m (-$0.5m impact on ECL).
- *Collective Provision Lifetime ECL Not Credit Impaired stage 2* – increased $2m driven by a net increase in gross balances of $5m. New lending of $10m (+$1m impact on ECL) was offset by repayments of $5m (-$0.1m impact on ECL).
- *Collective Provision Lifetime ECL Credit Impaired stage 3* – stable during the year to date with small transfers in and out from stage 1 and 2 offsetting each other. Gross balances reduced from $6m to $3m with $5m of repayments (-$0.8m impact on ECL) partially offset by $2m increase in balances.
- *Specific Provision Lifetime ECL Credit Impaired* – stable with no material movement in gross balances during the year to date.

Notes to the interim financial statements continued

4. Asset quality continued

Movement in provision for credit impairment – total exposures

Dollars in millions	Collective Provison (NZ IAS 39)	Collective Provision 12-months ECL Stage 1	Collective Provision Lifetime ECL Not Credit Impaired Stage 2	Collective Provision Lifetime ECL Credit Impaired Stage 3	Specific Provision Lifetime ECL Credit Impaired	Total
Unaudited as at 31 December 2018						
Total						
Balance at beginning of the period	31	-	-	-	5	36
Adjustment upon adoption of NZ IFRS 9	(31)	16	12	2	-	(1)
Transfers between stages:	-	-	-	-	-	-
- Transferred to Stage 1	-	3	(3)	-	-	-
- Transferred to Stage 2	-	(3)	3	-	-	-
- Transferred to Stage 3	-	-	-	-	-	-
- Transferred to specific provision	-	-	-	-	-	-
Charged / (credited) to income statement	-	2	-	(1)	3	4
Amounts written off	-	-	-	-	(3)	(3)
Recovery of amounts written off	-	-	-	-	-	-
Balance at end of period - total	-	18	12	1	5	36

Asset quality of loans and advances

Interest revenue foregone on impaired assets is calculated using actual interest written off and interest suspended during the period. There were no real estate or other assets acquired through the enforcement of security/collateral held at 31 December 2018 (31 December 2017: nil; 30 June 2018: nil). There were no assets under administration as at 31 December 2018 (31 December 2017: nil; 30 June 2018: nil).

There were no unrecognised impaired assets as at 31 December 2018 (31 December 2017: nil; 30 June 2018: nil). The aggregate amount of undrawn balances on lending commitments to counterparties for whom drawn balances are classified as individually impaired was $0.2m at 31 December 2018 (31 December 2017: $1.3m; 30 June 2018: $1.0m).

Credit quality of loans and advances neither past due nor impaired

A large portion of the credit exposures, such as residential mortgages, are secured. The fair value of associated security for these secured residential mortgages is sufficient to 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 loan characteristics and loan-to-valuation ("**LVR**") ratios. Non-retail advances are individually risk graded against similar characteristics. The behavioural scoring 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.

Credit quality of other financial assets

In addition to assessing impairment for loans and advances, the Banking Group has assessed the impairment requirements 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.

Notes to the interim financial statements continued

5. 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:

Dollars in millions	Unaudited as at 31/12/18
New Zealand	
Government, local authorities and services	891
Finance, investment and insurance	887
Households	17,547
Transport and storage	193
Professional, scientific and technical services	53
Electricity, gas and water	4
Construction	212
Property and business services	893
Agriculture	20
Health and community services	93
Personal and other services	96
Retail and wholesale trade	142
Food & other manufacturing	109
Overseas	
Finance, investment and insurance	742
	21,882
Less provision for credit impairment	(36)
Other financial assets	18
Total financial assets	**21,864**

From 1 July 2018, the Banking Group has applied NZ IFRS 9 in the disclosure of concentration of credit risk. “Allowance for impairment losses” has been renamed “provision for credit impairment” in the table above. See note 23 for more details of the related changes in accounting policies and impact of adoption.

Notes to the interim financial statements continued

5. Concentration of credit risk continued

Unaudited as at 31 December 2018 Dollars in millions	Maximum exposure	Collateral	Net exposure
Credit risk relating to balance sheet assets			
Fixed rate lending at amortised cost	15,651	(15,647)	4
Variable rate lending	3,282	(3,282)	-
Unsecured lending	419	-	419
Due from other financial institutions	342	-	342
Balances with related parties	82	-	82
Derivative financial instruments	326	(83)	243
Investment securities	1,333	-	1,333
Cash and cash equivalents	447	-	447
Other financial assets	18	-	18
	21,900	(19,012)	2,888
Less provision for credit impairment	(36)	-	(36)
Total financial assets	21,864	(19,012)	2,852

The table above represents the maximum net credit risk exposure of the Banking Group at 31 December 2018. The exposures set out are based on net carrying amounts as reported in the balance sheet. Australian and New Zealand Standard Industrial Classification ("**ANZSIC**") codes have been used as the basis for disclosing customer industry sectors.

The exposure of the Banking Group derived from loans and advances to retail and corporate customers is 89% of the total maximum exposure (31 December 2017: 89%; 30 June 2018: 89%).

The preceding table provides a quantification of the value of the financial charges the Banking Group holds over a borrower's specific asset (or assets) where the Banking Group is able to enforce the collateral in satisfying the debt in the event of the borrower failing to meet its contractual obligations. For the purposes of this disclosure, where collateral held is valued at more than the corresponding credit exposure, coverage is capped at the value of the credit exposure less amounts for which an individual impairment allowance has been recognised. The most common type of collateral is over real estate including residential, commercial, industrial and rural property. The Banking Group is potentially exposed to credit risk for undrawn loan commitments (note 18) for an amount equal to the undrawn balance.

6. Due from other financial institutions

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Short term advances due from other financial institutions	277	61	80
Collateralised loans	65	64	52
Total amounts due from other financial institutions - Current	342	125	132

As at 31 December 2018, included within the balance above, is $64.9m of collateral pledged by Kiwibank in respect of its credit support annex obligations to derivative counterparties (31 December 2017: $64.2m; 30 June 2018: $52.0m).

Notes to the interim financial statements continued

7. Deposits and other borrowings

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Demand deposits non-interest bearing	2,287	1,935	2,031
Demand deposits bearing interest	3,401	3,347	3,285
Term deposits	11,742	10,678	10,857
Total deposits from customers	17,430	15,960	16,173
Current	16,808	15,456	15,537
Non-current	622	504	636

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

The Kiwibank PIE Unit Trust (the "**Trust**"), established in May 2008, operates three funds; the PIE Term Deposit Fund, the Notice Saver and PIE Online Call Fund. Kiwibank Investment Management Limited is the Issuer and Manager (the "**Manager**"), Trustees Executors Limited is the Supervisor and Kiwibank is the Promoter of the Trust. Units in the Trust do not directly represent deposits or liabilities of Kiwibank, however the Trust is invested exclusively in term and call deposits with Kiwibank. At 31 December 2018, $4,182m of the Trust's funds were invested in Kiwibank products or securities (31 December 2017: $3,536m; 30 June 2018: $3,856m).

Kiwibank guarantees the payment obligations of the Manager and any amounts owing to Unitholders under the Trust Deed in respect of their Units and agrees to pay to Unitholders 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.

8. Debt securities issued

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Short term debt			
Commercial paper at fair value through profit or loss	-	464	298
Certificates of deposit	155	132	56
Long term debt			
Medium term notes	1,854	1,345	1,673
Covered bonds	226	215	223
Fair value hedge adjustment	18	14	15
Total debt securities issued	2,253	2,170	2,265
Current	875	612	898
Non-current	1,378	1,558	1,367

Notes to the interim financial statements continued

8. Debt securities issued continued

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 shareholders. 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.

Further information on the guarantee arrangements and other details relating to covered bonds are disclosed in note 15.

Kiwibank has not had any defaults of principal, interest or other breaches with respect to debt securities issued during the period (period ended 31 December 2017: none; year ended 30 June 2018: none).

9. Subordinated debt

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Kiwibank bonds	104	106	105
Perpetual capital bonds	149	149	149
Total subordinated debt	253	255	254
Current	3	3	3
Non-current	250	252	251

As at 31 December 2018, $100m (31 December 2017: $100m; 30 June 2018: $100m) of the subordinated debt qualified as Tier 2 capital for Capital Adequacy calculation purposes. The contractual terms of subordinated debt instruments on issue expressly provide that they do not have the benefit of the NZP Guarantee. The NZP Guarantee was terminated with an effective date of 28 February 2017.

The Banking Group has not issued any subordinated debt nor had any defaults of principal, interest or other breaches with respect to these liabilities during the period (period ended 31 December 2017: none; year ended 30 June 2018: none). The Banking Group has not repaid any subordinated debt during the period (period ended 31 December 2017: $150m; year ended 30 June 2018: $150m).

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 terms and conditions of the subordinated debt instruments on issue are as follows.

Instrument	Issue date	Amount ($m)	Coupon rate	Call date	Maturity date
Kiwibank bonds	6 June 2014	100	6.61% p.a.	15 July 2019	15 July 2024
Perpetual capital bonds	27 May 2015	150	7.25% p.a.	27 May 2020	None

The classification of subordinated debt as non-current, excluding interest accrued, is based on the contractual maturity date of the instruments because 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.

The Kiwibank Bonds have a maturity date of 15 July 2024, however, Kiwibank may elect to make an early repayment on 15 July 2019 after obtaining the consent of the RBNZ.

The Perpetual Capital Bonds have no maturity date, however, Kiwibank may elect to make an early repayment on 27 May 2020 after obtaining the consent of the RBNZ.

Notes to the interim financial statements continued

10. Financial instruments

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, for example 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.

Valuation methodology

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

Investment securities

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

Debt securities issued

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

Derivative financial instruments

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

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

Dollars in millions	Level 1	Level 2	Level 3	Total
Unaudited as at 31 December 2018				
Financial assets				
Investment securities	477	856	-	1,333
Derivative financial instrument assets	-	326	-	326
Total financial assets at fair value	477	1,182	-	1,659
Financial liabilities				
Derivative financial instrument liabilities	-	289	-	289
Debt securities issued	-	-	-	-
Total financial liabilities at fair value	-	289	-	289

Notes to the interim financial statements continued

10. Financial instruments continued

Dollars in millions	Level 1	Level 2	Level 3	Total
Unaudited as at 31 December 2017				
Financial assets				
Investment securities	457	691	-	1,148
Derivative financial instrument assets	-	350	-	350
Total financial assets at fair value	457	1,041	-	1,498
Financial liabilities				
Derivative financial instrument liabilities	-	346	-	346
Debt securities issued	-	464	-	464
Total financial liabilities at fair value	-	810	-	810

Dollars in millions	Level 1	Level 2	Level 3	Total
Audited as at 30 June 2018				
Financial assets				
Investment securities	411	809	-	1,220
Derivative financial instrument assets	-	344	-	344
Total financial assets at fair value	411	1,153	-	1,564
Financial liabilities				
Derivative financial instrument liabilities	-	293	-	293
Debt securities issued	-	298	-	298
Total financial liabilities at fair value	-	591	-	591

There have been no transfers between levels 1 and 2 during the period ended 31 December 2018 (period ended 31 December 2017: no transfers; year ended 30 June 2018: no transfers). There were also no transfers into/out of level 3 during the period ended 31 December 2018 (period ended 31 December 2017: no transfers; year ended 30 June 2018: no transfers).

	Unaudited as at 31/12/18		Unaudited as at 31/12/17		Audited as at 30/06/18	
Dollars in millions	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Assets						
Due from related parties	82	82	84	84	87	87
Investment securities	1,333	1,333	1,148	1,148	1,220	1,220
Derivative financial instruments	326	326	350	350	344	344
Loans and advances	19,316	19,355	18,027	18,082	18,304	18,371
Liabilities						
Due to related parties	5	5	7	7	8	8
Derivative financial instruments	289	289	346	346	293	293
Deposits and other borrowings	17,430	17,443	15,960	15,979	16,173	16,185
Debt securities issued	2,253	2,264	2,170	2,185	2,265	2,278
Subordinated debt	253	261	255	258	254	265

Notes to the interim financial statements continued

10. Financial instruments continued

The carrying values of the following financial instruments are a reasonable approximation of fair value because 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.

11. Credit exposure concentrations

Unaudited

Credit exposures to individual counterparties

Credit exposure concentrations are disclosed on the basis of actual credit exposures and gross of set-offs. Peak end-of-day aggregate credit exposures have been calculated using the Banking Group's Tier 1 capital at the end of the period.

There are no individual counterparties (excluding connected parties, governments and banks with long term credit ratings of A-, A3 or its equivalent or above), where the period end and peak end-of-day aggregate actual credit exposures, net of individual credit impairment allowances (which were nil),that equalled or exceeded 10% of the Banking Group's shareholders' equity as at the reporting date.

12. Concentration of funding

Dollars in millions	Unaudited as at 31/12/18
Analysis by industry sector	
New Zealand	
Transport and storage	122
Finance, investment and insurance	3,146
Electricity, gas and water	27
Food & other manufacturing	189
Construction	175
Communications	28
Government, local authorities and services	456
Agriculture	68
Health and community services	177
Personal and other services	285
Property and business services	402
Education	161
Retail and wholesale trade	78
Households	13,376
Overseas	
Finance, investment and insurance	1,397
Households	293
	20,380
Other financial liabilities	68
Total financial liabilities	20,448

Notes to the interim financial statements continued

12. Concentration of funding continued

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

13. Dividends paid

Unaudited

During the period ended 31 December 2018, Kiwibank paid ordinary dividends of $14m to KGHL (period ended 31 December 2017: nil; year ended 30 June 2018: nil).

14. Related parties

NZP has a credit facility with the Banking Group, allowing NZP to draw down to the extent that the Banking Group does not exceed credit exposure to connected persons of 15% of Tier 1 capital, as required in its banking conditions of registration. When loans are drawn down the transaction is undertaken at market interest rates. As at 31 December 2018 the amount owed by NZP to the Banking Group under the credit facility was $75.8m (31 December 2017: $76m; 30 June 2018: $75.8m). This does not exceed the current limit on credit exposure to connected persons of $238.5m, being 15% of Tier 1 capital.

On 31 October 2016, the Crown entered into a $300m uncalled capital facility with KGHL that allows the Banking Group to draw down capital for contingent events around Kiwibank's conditions of registration. The annualised cost of this facility on charged to Kiwibank is $3.0m.

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Outstanding balances			
Due to related parties	5	7	8
Included in derivative financial instruments - liabilities	2	3	2
Included in deposits	13	37	21
Included in subordinated debt	253	255	254
Total outstanding balances due to related parties	273	302	285
Receivables			
Due from related parties	82	84	87
Included in derivative financial instruments - assets	1	1	1
Included in loans and advances	2	3	4
Total receivables due from related parties	85	88	92

Notes to the interim financial statements continued

15. Fiduciary activities and securitisation

Unaudited

Provision of financial services

Financial services provided by Kiwibank to entities which are involved in trust, custodial, funds management and other fiduciary activities, are provided 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.

Insurance business

The Banking Group does not conduct insurance business. However, certain insurance products which are marketed through the Banking Group's retail network are underwritten by Kiwi Insurance Limited, a wholly owned subsidiary of KGHL, Kiwibank's immediate parent company.

Kiwi Covered Bond Trust

On 23 January 2013, the Kiwi Covered Bond Trust (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 Kiwi Covered Bond Trustee Limited, as Trustee of the Covered Bond Trust, have a priority claim over the assets of the Covered Bond Trust. Since 19 February 2013, selected Kiwibank housing loans have been transferred to the Covered Bond Trust in order to facilitate the Bank's covered bond programme. These assets do not qualify for derecognition as the Banking Group retains a continuing involvement and retains substantially all the risks and rewards of ownership of the transferred assets. The Covered Bond Trust is consolidated within the Banking Group.

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

The carrying value of the Covered Bond Trust pool at 31 December 2018 is $316m (31 December 2017: $316m; 30 June 2018: $316m). These securities are ring fenced to ensure they are not used as collateral outside of agreements established in relation to the Covered Bond Trust.

Kiwibank RMBS Trust Series 2009-1

The purpose of the Kiwibank RMBS Trust Series 2009-1 (the "**RMBS Trust**") is to provide an in-house residential mortgage-backed securities facility to issue securities as collateral for borrowing from the Reserve Bank of New Zealand. As at 31 December 2018, included within Loans and advances to customers on the Banking Group's consolidated balance sheet were housing loans with a carrying value of $1,100m held by the RMBS Trust (31 December 2017: $1,100m; 30 June 2018: $1,100m). These housing loans do not qualify for derecognition as the Bank retains substantially all of the risks and rewards of ownership. The RMBS Trust is consolidated within the Banking Group.

16. Segment analysis

For the purposes of determining reportable operating segments, the chief operating decision-maker has been identified as the Kiwibank Executive Committee ("**EXCO**"), which consists of the Chief Executive Officer and his direct reports. The EXCO reviews the Banking Group's internal reporting pack on a regular basis to assess performance and to allocate resources. A reportable 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 segments. The business segments are defined by the customers that they service and the services they provide.

Notes to the interim financial statements continued

16. Segment analysis continued

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 intersegment funding arrangements.

A summarised description of each business unit is shown below:

- Personal– Provides banking products and services to the personal banking segment.
- Business – Provides banking products and services to the business sector. Included within the segment are Business and Treasury services.

Dollars in millions	Personal markets	Business markets	Total
Unaudited 6 months ended 31 December 2018			
External revenues	256	17	273
Intersegment revenues	(74)	74	-
Total revenues	182	91	273
Profit before taxation	48	38	86
Unaudited 6 months ended 31 December 2017			
External revenues	262	1	263
Intersegment revenues	(87)	87	-
Total revenues	175	88	263
Profit before taxation	24	30	54
Audited year ended 30 June 2018			
External revenues	520	19	539
Intersegment revenues	(170)	170	-
Total revenues	350	189	539
Profit before taxation	71	83	154

17. Risk management

Unaudited

There have been no material changes to the Banking Group's policies for managing risk, or material exposures to new categories of risk since 30 June 2018.

18. Liquidity

The following table summarises the cash flows of the Banking Group by remaining contractual maturities as at the reporting date. The amounts disclosed are the contractual undiscounted cash flows and include principal and future interest cash flows and therefore may not agree to the carrying values on the balance sheet. Actual cash flow may differ significantly from the contractual cash flows disclosed below as a result of future actions of the Banking Group and/or its counterparties, such as early repayments or refinancing of term loans.

The majority of the longer term Loans and advances are housing loans which are likely to be repaid earlier than their contractual terms. Deposits and other borrowings include substantial customer savings deposits and cheque accounts, which are at call. History demonstrates that such accounts provide a stable source of long term funding for the Bank.

Notes to the interim financial statements continued

18. Liquidity continued

The Banking Group does not manage its liquidity risk on the basis of the information provided in the table below.

	Unaudited as at 31/12/18						
Dollars in millions	On demand	Up to 3 months	3 to 12 months	Between 1 & 5 years	More than 5 years	Gross nominal inflow/ outflow	Carrying amount
Non-derivative cash flows							
Liabilities							
Due to other financial institutions	(139)	-	-	-	-	(139)	(150)
Due to related parties	(5)	-	-	-	-	(5)	(5)
Deposits and other borrowings	(6,747)	(5,289)	(4,867)	(682)	-	(17,585)	(17,430)
Debt securities issued	(15)	(31)	(880)	(1,319)	(186)	(2,431)	(2,253)
Other financial liabilities	(68)	-	-	-	-	(68)	(68)
Subordinated debt	(3)	-	(3)	(26)	(257)	(289)	(253)
Total financial liabilities	(6,977)	(5,320)	(5,750)	(2,027)	(443)	(20,517)	(20,159)
Assets							
Cash and cash equivalents	447	-	-	-	-	447	447
Due from related parties	7	59	17	-	-	83	82
Due from other financial institutions	142	-	202	-	-	344	342
Investment securities	77	204	113	981	-	1,375	1,333
Loans and advances	198	401	1,198	4,372	31,653	37,822	19,316
Other financial assets	18	-	-	-	-	18	18
Total financial assets	889	664	1,530	5,353	31,653	40,089	21,538
Net non-derivative cash flows	(6,088)	(4,656)	(4,220)	3,326	31,210	19,572	1,379
Derivative cash flows - net							
Interest rate derivatives	(1)	(3)	(16)	(6)	(1)	(27)	
Total	(1)	(3)	(16)	(6)	(1)	(27)	
Derivative cash flows - gross							
Foreign exchange derivatives							
Inflow	115	110	506	742	186	1,659	
Outflow	(120)	(112)	(474)	(695)	(201)	(1,602)	
Total	(5)	(2)	32	47	(15)	57	
Off balance sheet cash flows							
Capital commitments	-	(3)	-	-	-	(3)	
Undrawn loan commitments	(3,194)	-	-	-	-	(3,194)	
Lease commitments	-	(2)	(6)	(25)	(45)	(78)	
Total	(3,194)	(5)	(6)	(25)	(45)	(3,275)	
Net cash flows	(9,288)	(4,666)	(4,210)	3,342	31,149	16,327	
Cumulative net cash flows	(9,288)	(13,954)	(18,164)	(14,822)	16,327	16,327	

Notes to the interim financial statements continued

18. Liquidity continued

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 consolidated cash flow statement. Amounts below are presented net of any appropriate haircut where applicable.

Dollars in millions	Unaudited as at 31/12/18
Cash, balances with central bank, and certain foreign currency deposits	405
Certificates of deposit	179
Government bonds and treasury bills	494
Local body stock and bonds	38
Other bonds	567
Total	1,683

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 NZ$855m at 31 December 2018 (31 December 2017: $855m, 30 June 2018: $855m).

Notes to the interim financial statements continued

19. Interest repricing

Dollars in millions	Total	Non-interest bearing	Up to 3 months	3 to 6 months	6 months to 1 year	Between 1 & 2 years	Over 2 years
	Unaudited as at 31/12/18						
Financial assets							
Cash and cash equivalents	447	47	400	-	-	-	-
Due from related parties	82	6	76	-	-	-	-
Due from other financial institutions	342	-	142	200	-	-	-
Investment securities	1,333	-	382	55	16	455	425
Derivative financial instruments	326	326	-	-	-	-	-
Loans and advances	19,316	73	5,214	2,052	5,642	5,199	1,136
Other financial assets	18	18	-	-	-	-	-
Total financial assets	21,864	470	6,214	2,307	5,658	5,654	1,561
Financial liabilities							
Due to other financial institutions	(150)	(11)	(84)	-	(55)	-	-
Due to related parties	(5)	(5)	-	-	-	-	-
Derivative financial instruments	(289)	(289)	-	-	-	-	-
Deposits and other borrowings	(17,430)	(2,287)	(9,799)	(2,462)	(2,264)	(385)	(233)
Debt securities issued	(2,253)	-	(824)	(267)	(139)	(434)	(589)
Other financial liabilities	(68)	(68)	-	-	-	-	-
Subordinated debt	(253)	-	-	-	(104)	(149)	-
Total financial liabilities	(20,448)	(2,660)	(10,707)	(2,729)	(2,562)	(968)	(822)
On-balance sheet gap	1,416	(2,190)	(4,493)	(422)	3,096	4,686	739
Net derivative notional principals	61	-	3,741	769	(2,292)	(2,916)	759
Net effective interest rate gap	1,477	(2,190)	(752)	347	804	1,770	1,498

The table above summarises the Banking Group's exposure to interest rate risk. It includes financial instruments at their carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The fair value adjustment on the revaluation of financial instruments is categorised in the appropriate repricing category.

20. Capital expenditure commitments

Unaudited

Capital expenditure commitments contracted for as at 31 December 2018, but not provided for in these interim financial statements, total $3.0m (31 December 2017: $7.2m; 30 June 2018: $9.2m). The full amount is due within 12 months and the amount due between one and five years from the reporting date is nil (31 December 2017: nil; 30 June 2018: nil).

Notes to the interim financial statements continued

21. Contingent liabilities and loan commitments

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

Dollars in millions	Unaudited as at 31/12/18	Unaudited as at 31/12/17	Audited as at 30/06/18
Loan commitments	3,194	2,910	3,032

There are no material contingent liabilities as at 31 December 2018 (31 December 2017: nil; 30 June 2018: nil).

22. Contingent assets

Unaudited

The Banking Group held insurance policies at the date of the Kaikoura earthquake that provided cover for Material Damage and Business Interruption. It is probable that the policies will enable the Banking Group to obtain a further reimbursement for various costs incurred as a result of the earthquake however there is insufficient information to form a reliable estimate of the financial effect.

23. Changes in accounting policies

Unaudited

This note explains the nature and effect of the changes in accounting policies for the Banking Group due to the adoption of NZ IFRS 9 *Financial Instruments* and NZ IFRS 15 *Revenue from Contracts with Customers* effective from 1 July 2018.

Impact of adoption of new accounting standards on the financial statements

The following table is an extract of the financial statements showing each individual line item that was adjusted on 1 July 2018 as a result of the adoption of new accounting standards. Comparative amounts have not been restated as permitted by the standards.

	Audited	Transitional adjustments resulting from the adoption of:*		Unaudited
Dollars in millions	30/06/18	NZ IFRS 15	NZ IFRS 9	01/07/18
Assets				
Loans and advances	18,304	-	1	18,305
Deferred taxation	11	1	-	12
Total assets	20,715	1	1	20,717
Liabilities				
Contract liabilities	-	6	-	6
Total liabilities	19,228	6	-	19,234
Shareholder's equity				
Reserves	750	(5)	1	746
Total shareholder's equity	1,487	(5)	1	1,483
Total liabilities and shareholder's equity	20,715	1	1	20,717

*the impact of transitional adjustments resulting from the adoption of NZ IFRS 15 and NZ IFRS 9 has been applied retrospectively by adjusting the opening balance of loans and advances, deferred taxation, and contract liabilities. The total cumulative effect of the transition has been recognised by adjusting opening retained earnings without restating comparatives as permitted by the standards.

Notes to the interim financial statements continued

23. Changes in accounting policies continued

NZ IFRS 9 Financial Instruments

Summary

NZ IFRS 9 replaced guidance in NZ IAS 39 *Financial Instruments: Recognition and Measurement* on the classification and measurement of financial instruments, impairment on financial assets, and new general hedge accounting requirements. The guidance on recognition and derecognition of financial instruments has been carried forward from NZ IAS 39.

Impairment of financial assets

NZ IFRS 9 replaced the incurred loss model under NZ IAS 39 with a forward-looking expected loss model. This model is now applied to financial assets measured at amortised cost, debt instruments measured at fair value through other comprehensive income, lease receivables, and certain loan commitments and financial guarantees. Under NZ IFRS 9, a three-stage approach is applied to measuring expected credit losses ("ECL") based on credit migration between the stages as follows:

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

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

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

ECL are probability weighted and determined by evaluating a range of possible outcomes, taking into account the time value of money, past events, current conditions and forecasts of future economic conditions. The new ECL models therefore involve a greater use of judgement than the previous impairment model.

The ECL models use three main components to determine expected credit loss (as well as 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.

The models use a 12-month timeframe for expected losses in stage 1 and a lifetime timeframe for expected losses in stages 2 and 3. 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 which include a central scenario reflecting the expected track for the economy and alternative scenarios incorporating upside and downside risks to that central scenario. The probability weightings attached to each scenario are reviewed by executive management half-yearly although more frequent reviews may be undertaken should macroeconomic conditions change materially.

The governance framework has been developed to implement appropriate controls to address the new requirements of NZ IFRS 9 including key areas of judgement such as the determination of a significant increase in credit risk and the use of forward looking information in future economic scenarios.

The determination of a significant deterioration of 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. The movement between stages 2 and 3 is based on whether financial assets are credit impaired at the reporting date.

Notes to the interim financial statements continued

23. Changes in accounting policies continued

Classification and measurement

NZ IFRS 9 contains a classification and measurement approach for financial assets that reflects the business model in which assets are managed and their contractual cash flow characteristics. Financial assets are now measured at:

- *amortised cost* where the business model is to hold the financial assets in order to collect contractual cash flows and those cash flows represent solely payments of principal and interest;
- *fair value through other comprehensive income* ("FVOCI") where the business model is to both collect contractual cash flows and sell financial assets and the cash flows represent solely payments of principal and interest. Non-traded equity instruments can also be measured at fair value through other comprehensive income; or
- *fair value through profit or loss* ("FVTPL") if they are held for trading or if the cash flows of the asset do not solely represent payments of principal and interest. An entity can also elect to measure a financial asset at fair value through profit or loss if it eliminates or reduces an accounting mismatch.

The classification and measurement requirements for financial liabilities under NZ IFRS 9 are largely consistent with NZ IAS 39 with the exception that for financial liabilities designated as measured at fair value, gains or losses relating to changes in the entity's own credit risk are now included in other comprehensive income.

The classification of the financial assets and liabilities upon adoption of NZ IFRS 9 is outlined below:

Dollars in millions	NZ IAS 39 Audited as at 30 June 2018		NZ IFRS 9 Unaudited as at 1 July 2018	
Financial assets	Classification	Amount	Classification	Amount
Cash and cash equivalents	Loans and receivables	447	Amortised cost	447
Due from related parties	Loans and receivables	87	Amortised cost	87
Due from other financial institutions	Loans and receivables	132	Amortised cost	132
Investment securities	Available-for-sale	1,220	FVOCI	1,220
Loans and advances	Loans and receivables	18,304	Amortised cost	18,305
Derivative financial instruments:				
Held for Trading	FVTPL	244	FVTPL	244
Used for Hedging	Derivatives used for hedging	100	Derivatives used for hedging	100
Other financial assets	Loans and receivables	27	Amortised cost	27
Financial liabilities				
Due to other financial institutions	Amortised cost	128	Amortised cost	128
Due to related parties	Amortised cost	8	Amortised cost	8
Deposits and other borrowings	Amortised cost	16,173	Amortised cost	16,173
Derivative financial instruments:				
Held for Trading	FVTPL	235	FVTPL	235
Used for Hedging	Derivatives used for hedging	58	Derivatives used for hedging	58
Debt securities issued:				
Commercial paper at FVTPL	Amortised cost	298	Amortised cost	298
Excluding commercial paper	Designated at FVTPL	1,967	FVTPL	1,967
Subordinated debt	Amortised cost	254	Amortised cost	254
Other financial liabilities	Amortised cost	69	Amortised cost	69

Notes to the interim financial statements continued

23. Changes in accounting policies continued

General hedge accounting

NZ IFRS 9 introduced general hedge accounting requirements which more closely align with risk management activities undertaken when hedging financial and non-financial risks. The new NZ IFRS model no longer requires specific quantitative measures for effectiveness testing and does not permit revocation of hedge designation.

NZ IFRS 9's approach to hedge accounting increases the eligibility of both hedged items and hedging instruments and applies a more principles-based approach to hedge effectiveness. Adoption of NZ IFRS 9's new hedge accounting model is optional until the International Accounting Standards Board ("IASB") completes its Accounting for Dynamic Risk Management project.

The Banking Group has elected to continue to apply the existing hedge accounting requirements of NZ IAS 39, as a policy choice permitted under NZ IFRS 9, although it will implement the amended NZ IFRS 7 hedge accounting disclosure requirements in the June 2019 disclosure statement.

Impact of transition

The total financial impact of the adoption of NZ IFRS 9 was a $0.5m increase in opening retained earnings (net of tax). The transition to NZ IFRS 9 resulted in an increase in loans and advances of $0.6m due to the adjustment to credit impairment provisions using the new ECL models with the balance being an adjustment to deferred tax.

NZ IFRS 15 Revenue from Contracts with Customers

NZ IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced previous revenue recognition guidance, including NZ IAS 18 *Revenue*, NZ IAS 11 *Construction Contracts* and NZ IFRIC 13 *Customer Loyalty Programmes*.

NZ IFRS 15 requires identification of distinct performance obligations within contracts with customers and allocation of the transaction price of the contract to those performance obligations. Revenue is recognised as each performance obligation is satisfied. Variable amounts of revenue can only be recognised if it is highly probable that a significant reversal of the variable amount will not be required in future periods.

The Banking Group completed an assessment on all material revenue streams by applying the five-step model framework of NZ IFRS 15 to all contracts with customers that are not specifically excluded from the scope of NZ IFRS 15. The majority of the Banking Group's revenue is outside the scope of NZ IFRS 15 due to the exclusion of revenue covered by other accounting standards including NZ IFRS 9 however, certain revenue streams have been impacted by the adoption of NZ IFRS 15.

Impact of transition

The revenue streams impacted include certain fees for card products and long-term contracts where the recognition of income is now required to be spread consistently with the fulfilment of the relevant performance obligations. The total financial impact of the adoption of NZ IFRS 15 was a $4.5m reduction in opening retained earnings (net of tax). The transition to NZ IFRS 15 resulted in the recognition of contract liabilities of $6.3m, representing unfulfilled performance obligations where revenue has already been received and previously recognised under NZ IAS 18 *Revenue*.

24. Events subsequent to the reporting date

Unaudited

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

Capital adequacy and regulatory liquidity ratios

Unaudited

The "**Banking Group**" consists of Kiwibank Limited ("**Kiwibank**" or the "**Bank**") and its subsidiaries. The Banking Group is subject to the capital adequacy requirements for registered banks as specified by the Reserve Bank of New Zealand ("**RBNZ**"). The RBNZ has set minimum acceptable regulatory capital requirements that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision.

The Bank must comply with RBNZ minimum capital adequacy ratios, as calculated under the Basel III framework in accordance with the RBNZ document *Capital Adequacy Framework (Standardised Approach)* (BS2A), as determined in its conditions of registration.

Ordinary shares

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

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

Perpetual capital bonds

The Perpetual capital bonds, issued by the Bank on 27 May 2015, and which are fully paid, are included within Additional Tier 1 capital. The Perpetual capital bond issue is subordinate to other term subordinated debt issues and all other general liabilities of the Banking Group and is 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 at an initial rate of 7.25% p.a. subject to the absolute discretion of Kiwibank;
c) interest is non-cumulative;
d) 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;
e) the Perpetual capital bonds do not have a maturity date, however, after obtaining the consent of the RBNZ, Kiwibank may elect to make early repayment on 27 May 2020 or any reset date thereafter (reset dates occur at 5-yearly intervals, commencing on 27 May 2020) or if a tax or regulatory event has occurred (as described in the Deed Poll); and
f) 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.

Capital adequacy and regulatory liquidity ratios continued

Unaudited

Convertible subordinated bonds ("Kiwibank Bonds")

The convertible subordinated bond issue, issued by the Bank on 6 June 2014, and which is fully paid, is included within Tier 2 capital. The issue is subordinate to all other general liabilities of the Banking Group and is denominated in New Zealand dollars. The material terms and conditions are:

a) the convertible subordinated bonds constitute direct, unsecured, subordinated debt obligations of Kiwibank;
b) interest on the convertible subordinated bonds is payable semi-annually at an initial rate of 6.61% p.a. subject to the condition that Kiwibank and the Banking Group is solvent after each payment;
c) the convertible subordinated 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;
d) the convertible subordinated bonds have a maturity date of 15 July 2024, however, after obtaining the consent of the RBNZ, Kiwibank may elect to make early repayment on 15 July 2019 or any semi-annual interest payment date thereafter; and
e) the convertible subordinated 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.

Risk 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: i) selected balance sheet assets; ii) off-balance sheet exposures and market contracts; and iii) business unit net income.

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 based on RBNZ Standardised Approach to Credit Risk methodology (BS2A).
- Market risk - The vulnerability of earnings to movements in interest rates and currency volatility. The risk based capital allocation is computed based on RBNZ Standardised Approach to Interest Rate 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 based on 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 typically higher than the regulatory minimum.

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and capital adequacy ratios for the period ended 31 December 2018. Throughout the period Kiwibank and the Banking Group complied with both regulatory and internal capital adequacy requirements.

Capital adequacy and regulatory liquidity ratios continued

Unaudited

Regulatory capital ratios

		The Banking Group		
	Regulatory Minima	31/12/18	31/12/17	30/06/18
Capital adequacy ratios				
Common Equity Tier 1 capital ratio	4.5%	13.0%	12.6%	13.4%
Tier 1 capital ratio	6.0%	14.4%	14.0%	14.8%
Total capital ratio	8.0%	15.3%	15.0%	15.8%
Buffer ratios				
Buffer ratio	2.5%	7.3%	7.0%	7.8%

	Kiwibank Limited		
	31/12/18	31/12/17	30/06/18
Capital adequacy ratios			
Common Equity Tier 1 capital ratio	12.5%	12.1%	12.9%
Tier 1 capital ratio	13.8%	13.5%	14.2%
Total capital ratio	14.6%	14.4%	15.1%

Capital adequacy and regulatory liquidity ratios continued

Unaudited

Regulatory capital

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

	The Banking Group		
Dollars in millions	31/12/18	31/12/17	30/06/18
Common Equity Tier 1 capital			
Issued and fully paid up share capital	737	737	737
Retained earnings (net of appropriations)	794	688	755
Accumulated other comprehensive income and other disclosed reserves [1, 2]	(3)	(5)	(5)
Less deductions from Common Equity Tier 1 capital			
Intangible assets	(81)	(84)	(78)
Cash flow hedge reserve	10	11	10
Deferred tax assets	(15)	(39)	(11)
Receivables from affiliated insurance group	(1)	(1)	(1)
Total Common Equity Tier 1 capital	1,441	1,307	1,407
Additional Tier 1 capital			
Perpetual capital bonds [3]	149	149	149
Total Additional Tier 1 capital	149	149	149
Total Tier 1 capital	1,590	1,456	1,556
Tier 2 capital			
Subordinated debt	100	100	100
Total Tier 2 capital	100	100	100
Total capital	1,690	1,556	1,656

[1] Includes fair value reserve of $7m. 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 ($10m). The cash flow hedging 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 issued by Kiwibank Limited are classified as debt of the Banking Group for financial reporting purposes.

Capital adequacy and regulatory liquidity ratios continued

Unaudited

On-balance sheet exposures

	31/12/18			
Dollars in millions	Total exposure	Risk weighting	Risk weighted exposure	Minimum Pillar I capital requirement
On-balance sheet exposures				
Cash and gold bullion	47	0%	-	-
Sovereigns and central banks	921	0%	-	-
Multilateral development banks and other international organisations	371	0%	-	-
Public sector entities	25	20%	5	-
	4	100%	4	-
Banks	633	20%	127	10
	113	50%	57	5
Corporate	35	20%	7	1
	76	50%	38	3
	950	100%	950	76
Non-property investment residential mortgage loans				
<= 80% loan to value ratio ("LVR")	10,354	35%	3,624	290
80 <= 90% LVR	750	50%	375	30
90 <= 100% LVR	63	75%	47	4
> 100% LVR	97	100%	97	8
Non-property investment residential mortgage loans - Welcome home loans and lenders mortgage insured loans				
<= 80% LVR	304	35%	106	8
80 <= 90% LVR	423	35%	148	12
90 <= 100% LVR	37	50%	19	2
Property investment residential mortgage loans				
<= 80% LVR	5,623	40%	2,249	180
80 <= 90% LVR	95	70%	67	5
90 <= 100% LVR	24	90%	22	2
> 100% LVR	38	100%	38	3
Property investment residential mortgage loans - Welcome home loans and lenders mortgage insured loans				
<= 80% LVR	31	40%	12	1
80 <= 90% LVR	2	50%	1	-
Impaired assets	5	100%	5	-
Past due residential mortgages greater than 90 days	6	100%	6	-
Other past due assets	3	150%	5	-
Non risk weighted assets	420	0%	-	-
Other assets	590	100%	590	47
Total on-balance sheet exposures	22,040		8,599	687

Capital adequacy and regulatory liquidity ratios continued

Unaudited

Off-balance sheet exposures and market related exposures

	31/12/18					
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	11	100%	11	100%	11	1
Commitment with certain drawdown	176	100%	176	100%	176	14
Performance-related contingency	9	50%	5	100%	5	-
Other commitments where original maturity is greater than one year	794	50%	397	43%	171	14
Other commitments where original maturity is less than or equal to one year	1,200	20%	240	37%	89	7
Other commitments that cancel automatically when the creditworthiness of the counterparty deteriorates or that can be cancelled unconditionally at any time without prior notice	1,015	0%	-	-	-	-
Market related contracts: [1]						
(a) Foreign exchange contracts	1,531	n/a	140	45%	63	5
(b) Interest rate contracts	25,159	n/a	311	38%	118	9
(c) Credit Valuation Adjustment					98	8
Total off-balance sheet exposures	29,895		1,280		731	58

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

Residential mortgages by loan-to-value ratio

	31/12/18		
Dollars in millions	On-balance sheet	Off-balance sheet	Total
LVR 0% - 80%	16,320	568	16,888
LVR 80% - 90%	1,271	32	1,303
LVR 90% +	261	21	282
Total	17,852	621	18,473

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

At 31 December 2018, of the loans with an LVR greater than 80%, $433m relates to “Welcome 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

Unaudited

Reconciliation of residential mortgage-related amounts

Dollars in millions	31/12/18
Residential mortgages total on-balance sheet exposures	17,852
Collective allowance for impairment	15
Deferred arrangement fees	85
Gross residential mortgage loans per asset quality (note 4)	17,952
Residentially secured lending included within 'Other term lending'	(881)
Gross 'term loans - housing' per loans and advances (note 3)	17,071

Credit risk mitigation

	31/12/18			
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	(25,515)	-	(206)	(17)
	(25,515)	-	(206)	(17)

Operational risk

	31/12/18	
Dollars in millions	Implied risk weighted exposure	Total operational risk capital requirement
Operational risk	1,334	107

Market risk

	31/12/18			
	Implied risk weighted exposure		Aggregate capital charge	
Dollars in millions	End of period	Peak end-of-day	End of period	Peak end-of-day
Interest rate risk	616	652	49	52
- of which relates to trading book	30	41	2	3
Foreign currency risk	9	17	1	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.

Capital adequacy and regulatory liquidity ratios continued

Unaudited

Total capital requirements

	31/12/18		
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	26,420	9,124	728
Operational risk	n/a	1,334	107
Market risk	n/a	625	50
Total Pillar I risk	n/a	11,083	885

Other material risk (Pillar II)

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

- Earnings risk – The current or prospective risk to earnings and growth targets arising from changes in the business environment and from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment.
- Other risks – Including changes to external ratings, IT infrastructure replacement, and cyber risks.

The Bank has made an internal capital allocation of $60m (31 December 2017: $47m; 30 June 2018: $60m).

Regulatory liquidity ratios

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

	Three months ended 31/12/18	Three months ended 30/09/2018
Average one-week mismatch ratio	8.0%	8.1%
Average one-month mismatch ratio	8.3%	8.0%
Average core funding ratio	89.5%	89.5%

Independent review report

To the readers of Kiwibank Limited's Disclosure Statement for the six months ended 31 December 2018 (the "Disclosure Statement").

The Auditor-General is the auditor of Kiwibank Limited (the "Bank") and the entities it controlled as at 31 December 2018 or from time-to-time during the six months ended on that date (the "Banking Group"). The Auditor-General has appointed me, Michele Embling, using the staff and resources of PricewaterhouseCoopers, to carry out the annual audit of the Bank and the Banking Group, on his behalf.

In our capacity as auditor, we have carried out a review of the:

- interim financial statements of the Banking Group on pages 5 to 33 which comprise the balance sheet as at 31 December 2018, the income statement, the statement of comprehensive income, the statement of changes in equity and the cash flow statement for the six months ended on that date, and a summary of significant accounting policies and selected explanatory notes; and
- supplementary information on pages 34 to 41 as required by Schedules 5, 7, 9, 13, 16 and 18 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order") for the six months ended 31 December 2018 (the "supplementary information").

Review conclusion

Based on our review, nothing has come to our attention that causes us to believe that:

- the interim financial statements (excluding the supplementary information) of the Banking Group are not prepared, in all material respects, in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* (NZ IAS 34) and International Accounting Standard 34: *Interim Financial Reporting* (IAS 34);

- the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements) prescribed by Schedules 5, 7, 13, 16 and 18 of the Order does not fairly state the matters to which it relates in accordance with those Schedules; and

- the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed on pages 34 to 41 is not, in all material respects, prepared in accordance with the Bank's Conditions of Registration and disclosed in accordance with Schedule 9 of the Order.

The review was completed on 20 February 2019, and this is the date at which our review conclusion is expressed.

Responsibilities of the Directors

The Directors of Kiwibank Limited (the "Directors") are responsible on behalf of the Bank for the preparation and presentation of the Disclosure Statement, which includes interim financial statements in accordance with Clause 25 of the Order.

The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of the Disclosure Statement that is free from material misstatement, whether due to fraud or error. In addition, the Directors are responsible, on behalf of the Bank, for including the supplementary information in the Disclosure Statement that complies with schedules 3, 5, 7, 9, 13, 16 and 18 of the Order.

These responsibilities are specified in the Order issued pursuant to the Reserve Bank of New Zealand Act 1989.

Our responsibility

Our responsibility is to express the following conclusions on the interim financial statements and the supplementary information presented by the Directors based on our review:

- *on the interim financial statements (excluding the supplementary information):*
  whether, on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the interim financial statements have not been prepared, in all material respects, in accordance with NZ IAS 34 and IAS 34;

- *on the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements):*
  whether, on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements) does not fairly state the matters to which it relates in accordance with Schedules 5, 7, 13, 16 and 18 of the Order; and

- *on the supplementary information relating to capital adequacy and regulatory liquidity requirements:*
  whether, on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements is not in all material respects prepared in accordance with the Bank's Conditions of Registration and disclosed in accordance with Schedule 9 of the Order.

We conducted our review in accordance with New Zealand Standard on Review Engagements 2410: *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410"). As the auditor of the Bank, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

A review in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly, we do not express an audit opinion on the interim financial statements or on the supplementary information.

In completing our review, we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

In addition to the review, we have carried out agreed upon procedures engagements and a controls assurance engagement, which are compatible with those independence requirements. Certain partners and employees of our firm may deal with the Bank and the Banking Group on normal terms within the ordinary course of trading activities of the Bank and the Banking Group. Other than the review, these engagements and dealings in the ordinary course of trading activities of the Bank and the Banking Group, we have no relationship with or interests in the Bank or the Banking Group.

Michele Embling
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers