



Shoulder Number B.38

Kiwi Group Capital Limited
and subsidiaries

Statement of Performance Expectations

For the year ending 30 June 2026

Table of contents

Statement of responsibility.....	3
Our purpose and approach	4
KGCL Prospective Consolidated Financial Statements.....	5
Appendix: Summary of significant accounting policies	8

Statement of responsibility

This Statement of Performance Expectations is submitted by the Board of Directors of Kiwi Group Capital Limited (KGCL), pursuant to the Crown Entities Act 2004.

This Statement of Performance Expectations sets out the forecast performance of the KGCL Group or “the Group” (made up of Kiwibank Limited (Kiwibank) and its subsidiaries, and the New Zealand Home Loan Company Limited (NZHL) and its subsidiaries. KGCL is a for-profit entity incorporated and domiciled in New Zealand under the Companies Act 1993.

The KGCL Group’s prospective financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP).

The KGCL Group’s audited accounts for the year ending 30 June 2026 will be prepared in accordance with NZ GAAP and comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards, as appropriate for for-profit entities, the Financial Markets Conduct Act 2013 and also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).



David McLean

Chair



Michael Pohio

Director



Rukumoana Schaafhausen

Director



Catherine Savage

Director

Our purpose and approach

Why are we here?

KGCL was established in November 2022 as a holding company to oversee the investment in its subsidiaries Kiwibank and NZHL, and indirectly through those subsidiaries, to carry on and develop their businesses, including the provision of banking and financial services.

KGCL's Constitution establishes it as a commercial enterprise that:

- seeks to maximise long-term value and returns to the owner;
- is as profitable and efficient as comparable privately-owned businesses; and,
- exhibits a sense of social and environmental responsibility.

KGCL is a Public Finance Act 1989, Schedule 4A Company. Kiwibank and NZHL are subsidiaries of a Public Finance Act 1989 Schedule 4A company. Under section 45OA of the Public Finance Act 1989, certain provisions of the Crown Entities Act 2004 apply to KGCL as if it were a Crown entity company.

KGCL has a Board of Directors appointed by the Minister of Finance and the Minister for State Owned Enterprises. KGCL operates as an independent commercial entity on an arm's length basis from the Crown and is governed by:

- Public Finance Act 1989
- Companies Act 1993
- Crown Entities Act 2004
- Ombudsman Act 1975
- Public Audit Act 2001
- Public Service Act 2020

KGCL's purpose is to ensure that the government's objectives for Kiwibank and NZHL are achieved. For Kiwibank the Crown's objective is for it to remain wholly New Zealand owned and majority Crown owned, being able to challenge the status quo of the other major banks in the financial services industry, grow on a commercially sustainable basis and offer a competitive alternative for New Zealanders.

KGCL also holds the Crown's interest in NZHL. NZHL is licenced as a Financial Advice Provider with the Financial Markets Authority (FMA). NZHL operates via franchises which are registered with the FMA as an Authorised Body and operate under NZHL's Financial Advice Provider licence. Both NZHL and its franchises are regulated by the FMA. NZHL Financial Advisers are registered on the Financial Service Providers Register and provide advice on home loan and insurance products.

Reportable classes of output

For the Financial Year 2025/26 KGCL has no reportable classes of output.

KGCL Prospective Consolidated Financial Statements

Statement of Significant Assumptions

The forecast financial information is based on assumptions which the KGCL Group reasonably expects to occur. These key assumptions include:

Official Cash Rate (OCR)

The OCR track is forecast based on external data and subject matter expert judgement. Market pricing at the time of preparing the Business Plan indicated a terminal OCR of 3% and then rising to 4% in FY28.

Credit market and lending growth

In FY26 credit growth expected for home lending of 5.3% and business lending of 4.5%. Lending growth is a function of credit market growth and is assumed to grow in line with historical long run averages, subject to capital funding.

Deposit growth

Deposits provide funding to enable lending growth. Deposit growth is a function of lending growth and is assumed to grow in line with historical averages.

Inflation

Operating and capital expenditure forecasts take into account the level of inflation and wage inflation expected to the existing cost base. The rate of inflation and wage inflation is based on external forecasts. Inflation in NZ has returned to within the RBNZ 1-3% target band and inflation expectations are stable.

The forecast assumptions are considered to be reasonable and supportable, and they are consistent with the KGCL Business Plan which also includes more detailed assumptions that are commercially confidential in nature. The actual results achieved for the period covered are likely to vary from the forecast information presented, and these variations may be material.

The purpose of the forecast financial information is to enable compliance with the Crown Entities Act 2004 (Section 149G). The information as presented may not be appropriate for purposes other than that described.

Financial Performance Measures

The relevant performance measures are:

	FY24 Actual	FY25 Forecast	FY26 Target
NPAT (\$m)	205	187	209
Cost to Income (CTI)	66.4%	68.8%	69.0%
Return on Equity (RoE)	8.3%	6.8%	6.8%

Reporting against the above financial performance measures will either be included in or able to be calculated from the information in the Annual Report.

Prospective Statement of Comprehensive Income

For the year ending 30 June 2026

	\$m
Operating income	1022
Operating expenses	(705)
Profit before impairment and taxation	317
Credit impairment losses	(23)
Profit before taxation	294
Income tax expense	(85)
Profit after taxation	209
Net gains from changes in reserves ¹	22
Total comprehensive income for the year	231

Prospective Statement of Changes in Equity

For the year ending 30 June 2026

	\$m
Equity at start of the year	3,188
Profit for the year	209
Other comprehensive income for the year	22
Transactions with owners	(22)
Equity at end of the year	3,327

¹ That may subsequently be reclassified to profit or loss.

Prospective Statement of Financial Position

As 30 June 2026

	\$m
Total assets	44,546
Total liabilities	41,219
Share capital	2,110
Reserves	720
Perpetual preference shares	497
Total equity	3,327
Total liabilities and equity	44,546

Prospective Statement of Cash Flows

For the year ending 30 June 2026

	\$m
Net cash flows from/(to):	
Operating cash flows	(722)
Investing activities	(25)
Financing activities	747
Net increase/(decrease) in cash held	0
Cash at start of the year	1,074
Cash at end of the year	1,074

Appendix: Summary of significant accounting policies

Basis of preparation

These prospective consolidated financial statements are based on the general principles of historical cost accounting, modified by the application of fair value measurements for financial instruments held at fair value through other comprehensive income, and financial instruments held at fair value through profit or loss. 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.

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

Foreign currency transactions are translated into the functional currency at the exchange rate at the date of the transaction. At the reporting date, foreign currency denominated monetary assets and liabilities are translated at the closing exchange rate. Any foreign currency translation gains and losses are recognised in the income statement.

The principal accounting policies adopted in the preparation of these prospective financial statements are set out below.

Basis of consolidation

These prospective consolidated financial statements comprise the financial statements of the Parent and its subsidiaries. Subsidiaries are entities that are controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

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

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

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

Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. On the date of acquisition of a subsidiary, identifiable assets and liabilities acquired are initially measured at fair value.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of the net assets acquired, the difference is recognised directly in the income statement.

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

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

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

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

Financial instruments

Recognition

Financial assets and financial liabilities, other than regular way transactions, are recognised when the Group becomes a party to the terms of the contract, which is generally on the settlement date (the date payment is made or cash advanced). Purchases and sales of financial assets in regular way transactions are recognised on the trade date (the date on which the Group commits to purchase or sell an asset).

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

Derecognition

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

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

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

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

Classification

Financial assets

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

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

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

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

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

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

Financial assets in this category include investment securities.

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

All other financial assets are classified as measured at FVTPL.

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

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

Financial liabilities

Financial liabilities in 'derivative financial instruments' are classified as measured at FVTPL. All other financial liabilities are classified as measured at amortised cost. Financial liabilities in this category include 'due to other financial institutions', 'Deposits' 'debt securities issued', 'subordinated debt' and other financial liabilities.

Cash flow statement

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

- i) *Cash and cash equivalents* are considered to be cash on hand, current accounts with banks, ATMs and overnight bank deposits, net of bank overdrafts and balances held with the Reserve Bank of New Zealand ("RBNZ").
- ii) *Investing activities* are those relating to the acquisition, holding and disposal of premises and equipment, intangibles, and other long-term assets.

- iii) *Financing activities* are those activities which result in changes in the size and composition of the capital structure of the Group. This includes both equity and debt not falling within the definition of cash. Repurchase agreements related to the Funding for Lending Programme and the Term Lending Facility have been included as financing activities.
- iv) Operating activities include all transactions and other events that are not investing or financing activities. The holding of investment securities has been classified as an operating activity for the purposes of the cash flow statement as they are considered a principal revenue-producing activity of the Group
- v) Certain cash flows have been netted to provide more meaningful disclosure, including changes in investment securities, loans and advances, balances due from other financial institutions, deposits, balances due to other financial institutions and other assets and other liabilities. Many of the cash flows are received and disbursed on behalf of customers and reflect the activities of the customers rather than those of the Group.

Finance costs

Finance costs represent the effect of measuring the liability component of a compound financial instrument at amortised cost using the effective interest method.

Interest income and expense

Interest income and expense recognition

Interest income and interest expense for all interest earning financial assets and interest-bearing financial liabilities at amortised cost or FVOCI, detailed within the table below, are recognised in profit or loss using the effective interest rate method. Interest income and interest expense on financial instruments at FVTPL is recognised on an accrual basis with reference to contractual interest rates. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument. When calculating the effective interest rate for financial instruments, the Group estimates future cash flows considering all contractual terms of the financial instrument but not expected credit impairment losses.

Fees paid or received between parties that are an integral part of the effective interest rate of a financial instrument, are deferred and amortised to interest income or interest expense over their expected life as an adjustment to the effective interest rate, unless the financial instrument is measured at FVTPL. In those cases, the fees are recognised as revenue or expense when the instrument is initially recognised.

All other fees paid or received are recognised within 'Other operating income' when incurred

Other operating income

Fees and commission income recognition

Fees and commission income is recognised as services are performed and the related performance obligations are fulfilled. The transaction price for contracts with customers, including any estimated variable consideration, is allocated to each distinct performance obligation within each contract. The allocation of the transaction price to a performance obligation is based on the exact terms of the contract or, in the absence of exact terms, an appropriate method is used to estimate the price such as an adjusted market assessment approach, expected cost plus a margin approach, the residual approach, or a combination of these methods. The nature and timing of the satisfaction of performance obligations in contracts with customers for each type of service are outlined further below.

The Banking Group receives fee and commission income from third parties when acting as agent by arranging a third party to provide goods or services to customers. In such cases, the Banking Group does not control the provision of the goods or services and recognises the net revenue received within fees and commission income (i.e., the gross amount received from the customer less amounts paid to the third-party provider).

Fees and commission expense

Fees and commissions expenses are those that are not considered to form an integral part of the effective interest rate of a financial instrument. These include incremental costs that vary directly with the provision of goods or services to customers. Incremental costs are those that would not have been incurred if a specific good or service had not been provided to a specific customer.

Operating expenses

Operating expenses recognition

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

Research and development costs

Research and development ("R&D") costs primarily relate to software-as-a-service ("SaaS") arrangements. SaaS arrangements are cloud computing applications where the underlying software and associated infrastructure are hosted by a service provider independent of the Group. SaaS arrangements do not generally meet the intangible asset recognition criteria.

If costs do not meet the definition of an intangible asset, they are expensed as research and development in the period within which they are incurred.

Research and development tax incentives ('RDTI') are recognised as a receivable and a credit to expenses when the relevant supplementary return is submitted to the Inland Revenue and there is considered reasonable assurance that conditions of the RDTI have been met and the grant will be received.

Employee benefits

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

Leases

The Group recognises the depreciation expense related to right-of-use assets within operating expenses and interest costs in respect of lease liabilities within interest expense.

Taxation

The income tax expense charged to the income statement includes both current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

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

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

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

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority and there is a legally enforceable right to offset and the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

The Kiwibank Consolidated Tax Group includes Kiwi Group Capital Limited and its subsidiaries for tax purposes.

Loans and advances

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

Credit impairment losses

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

- financial assets measured at amortised cost;
- debt instruments measured at FVOCI; and
- certain loan commitments and financial guarantees.

Measurement of ECL

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

- Stage 1:** On initial recognition, a provision equivalent to 12 months of ECL is recognised.
- Stage 2:** Where there has been a significant increase in credit risk since initial recognition, a provision equivalent to full lifetime ECL is recognised.
- Stage 3:** This stage comprises all accounts that are impaired or in default. Lifetime ECL is recognised for loans where there is objective evidence of impairment. Where an economic loss is expected, a specific provision is raised which is calculated as the difference between contracted cash flows and the estimated realisable value of the security.

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

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

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

Changes to ECL are assessed through four economic scenarios:

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

The macroeconomic variables used in these scenarios are based on current economic forecasts and are the Consumer Price Index ("CPI"), Gross Domestic Product ("GDP"), unemployment rate, interest rates, and the house price index. The probability weightings attached to each scenario are reviewed by Kiwibank's Executive Risk Committee at least half-yearly, with the scenarios and the associated probability weightings reviewed more frequently when there are material changes in macroeconomic conditions impacting the economy.

The determination of a significant increase in credit risk (i.e., the movement from stage 1 to stage 2) is based on changes in internally assessed customer risk characteristics since origination of the loan facility. Those changes include arrears on loan facilities (at or less than the 30-day backstop), material movements in customer credit ratings or behavioural scores, or other information the Group becomes aware of which indicates that there has been a significant increase in credit risk since origination. Where terms have not been substantially modified, the existing financial asset is not derecognised, and its date of origination continues to be used to determine SICR. When SICR conditions are no longer applicable, they move back to stage 1, with no probationary period applied.

Credit-impaired financial assets

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

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

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

A loan that has been renegotiated due to a temporary deterioration in the borrower's condition is usually transitioned to stage 2 (e.g., due to hardship). These renegotiated loans would not be considered credit impaired unless there is evidence that deterioration may be for an extended period so that a detrimental impact has occurred on the estimated future cash flows for that loan. When SICR conditions are no longer applicable or the financial asset is no longer credit-impaired, they move back to earlier stage designations, with no probationary period applied.

When assessing ECL, other credit risks are considered where there is an identified risk but no observable data demonstrating historical losses is available. Model overlays can be used in these circumstances where the existing inputs, assumptions and model techniques do not fully capture all the risk factors to the Group's lending portfolios.

Presentation of allowance for ECL in the balance sheet

Credit impairment provision for ECL is presented in the balance sheet as follows:

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

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or partially. This is generally the case when the Group determines that the borrower does not

have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

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

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

Due from other financial institutions

Collateral paid balances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. Any interest calculated using the effective interest method, ECL and reversals, and foreign exchange gains and losses are recognised in the income statement.

Certain short-term advances due from other financial institutions form part of a portfolio measured at fair value through other comprehensive income ("FVOCI"). Gains and losses are recognised in other comprehensive income, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost: any interest calculated using the effective interest method; ECL and reversals; and foreign exchange gains and losses. On derecognition, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to the income statement. All other short-term advances are measured at amortised cost.

Investment securities

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

Derivative financial instruments and hedging activities

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

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

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

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

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

Fair value hedge

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

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

Cash flow hedge

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

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

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

Derivatives held for trading

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

Due to other financial institutions

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

Repurchase agreements

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

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

Deposits

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

Debt securities issued

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

Subordinated debt

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

Financial instruments

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

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

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

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

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

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

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

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

Offsetting financial assets and liabilities

The Group enters into contractual arrangements with counterparties to manage the credit risks associated primarily with over-the-counter derivatives, repurchase and reverse repurchase transactions. The Group also has agreements with some of its institutional counterparties to settle certain derivatives via a central clearing counterparty ("CCP"). These netting agreements and similar arrangements enable counterparties to offset liabilities against assets if an event of default or other predetermined event occurs and may require the posting of collateral; however, they generally do not result in net settlement in the ordinary course of business. Consequently, the Group does not offset its financial assets and liabilities in the balance sheet even if these amounts are subject to enforceable netting arrangements.

Intangible assets

Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of the fair value of the purchase consideration over the fair value of the Group's share of the assets acquired and the liabilities (and contingent liabilities) assumed on the date of the acquisition.

Computer software

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

Testing for impairment

The Group tests intangibles for impairment:

- at least annually for indefinite life intangibles, intangibles not yet available for use and goodwill; and
- where there is an indication that the asset may be impaired (which is assessed at least each reporting date); or
- where there is an indication that previously recognised impairment (on assets other than goodwill) may have changed.

Assets are impaired if their recoverable amount is less than their carrying amount. An impairment loss is recognised in profit or loss for the difference. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

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

Other liabilities

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

Provisions

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

Contract liabilities

Where the transaction price for a contract with a customer is received before the Group has satisfied the related performance obligations, a contract liability is recognised.

Lease liabilities

At the commencement date of the lease, the Group recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments less any lease incentives receivable, variable lease payments that depend on an index or a rate, and any amounts expected to be paid under residual value guarantees. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Group and payments of penalties for terminating the lease, if the lease term reflects the Group exercising the option to terminate. The Group's leases primarily relate to property leases for corporate offices and retail branch sites that are either direct leases or subleases.

Equity

Share capital

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

Non-controlling interests

- i) Perpetual preference shares are recognised at the amount paid up per perpetual preference share, net of directly attributable issue costs.
- ii) Discretionary distributions made in respect of perpetual preference shares are recognised as a liability in the consolidated financial statements in the reporting period in which the distribution is approved and are recognised as deductions from equity.

Other reserves

- i) Fair value reserve includes changes in the fair value of investment securities, net of tax. When the asset is derecognised these changes in fair value are transferred to the income statement. If an investment security asset held at FVOCI is impaired the associated impairment charge is recognised in the income statement.
- ii) Cash flow hedge reserve includes the fair value gains or losses associated with the effective portion of designated cash flow hedging instruments, net of tax.

Contingent liabilities and loan commitments

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

Compliance, regulation and remediation

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

Loan commitments

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