Bank of New Zealand

# Disclosure Statement

For the six months ended 31 March 2011

No. 61

# Disclosure Statement

*For the six months ended 31 March 2011*

This Disclosure Statement has been issued by Bank of New Zealand for the six months ended 31 March 2011 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2011 (the "Order").

In this Disclosure Statement, unless the context otherwise requires:

a) "Banking Group" means Bank of New Zealand's financial reporting group, which consists of Bank of New Zealand, all of its controlled entities and entities consolidated for financial reporting purposes; and

b) Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

## Contents

# Bank of New Zealand Corporate Information

## Address for Service

The name of the Registered Bank is Bank of New Zealand (referred to either by its full name or as the "Bank" or the "Company") and its address for service is Level 4, 80 Queen Street, Auckland, New Zealand.

## Nature of Business

The Bank was incorporated on 29 July 1861. The Banking Group provides a broad range of banking and financial products to retail, business, agribusiness, corporate and institutional clients.

## Guarantees

**Wholesale funding guarantee** – Certain debt securities issued by the Bank, or its subsidiary, BNZ International Funding Limited (London Branch), prior to 30 April 2010 are guaranteed by the Crown under the Crown's wholesale funding guarantee scheme (the "Scheme"). The Scheme was closed to new guarantees on 30 April 2010. The guarantor under the Scheme is Her Majesty the Queen in right of New Zealand acting by and through the Minister of Finance (the "Crown"). The Crown's address for service is 1 The Terrace, Wellington 6011, New Zealand.

The Scheme guarantees certain payment obligations of the Bank in respect of principal and interest (excluding penalty interest) owing under the guaranteed debt securities. The expiry date of the guarantee is the earlier of the maturity date of the guaranteed obligation or five years after the issue date of the guaranteed obligation.

A guarantee eligibility certificate is issued in respect of each issue of debt securities that is covered by the Crown wholesale funding guarantee. Copies of the guarantee eligibility certificates issued to Bank of New Zealand and information about the Scheme are available from New Zealand Treasury's website – www.treasury.govt.nz/economy/guarantee/wholesale.

The information about the Crown's wholesale funding guarantee above is a brief summary only. The full wholesale funding guarantee should be reviewed by any person intending to rely on the guarantee to ensure they understand how it will apply to their circumstances. Any person intending to rely on the wholesale funding guarantee should also search the relevant eligibility certificates. Further details can also be obtained by referring to the Bank's General Disclosure Statement for the year ended 30 September 2010 which is available at www.bnz.co.nz.

**Covered bond guarantee –** Certain debt securities ("Covered Bonds") issued by the Bank, or its subsidiary, BNZ International Funding Limited (London Branch), are guaranteed by the CBG Trustee Company Limited, solely in its capacity as trustee of the BNZ Covered Bond Trust (the "Covered Bond Guarantor"). The Covered Bond Guarantor has guaranteed the payment of interest and principal under the Covered Bonds pursuant to a guarantee which is secured over a pool of assets. The Covered Bond Guarantor's address for service is Level 10, 141 Willis Street, Wellington, New Zealand. The Covered Bond Guarantor is not a member of the Banking Group and has no credit ratings applicable to its long term senior unsecured obligations payable in New Zealand dollars. The Covered Bonds have been assigned a long term rating of Aaa by Moody's Investors Service. Refer to note 7 for further information.

Other material obligations of the Bank are not guaranteed.

## Ultimate Parent Bank and Address for Service

The ultimate parent bank of Bank of New Zealand is National Australia Bank Limited whose address for service is Level 4 (UB 4440), 800 Bourke Street, Docklands, Victoria 3008, Australia.

## Pending Proceedings or Arbitration

The Bank's Directors are of the opinion that there are no pending proceedings or arbitrations concerning any member of the Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on the Registered Bank or the Banking Group.

## Other Material Matters

A large scale earthquake struck the Canterbury region on 22 February 2011 which has impacted customers, employees and branches of Bank of New Zealand. As at 31 March 2011, an allowance of $60 million has been provided to reflect potential credit losses from the September 2010 and February 2011 earthquake events. This comprises amounts taken in the prior and current financial years.

The Bank's Directors are of the opinion that there are no other matters relating to the business or affairs of the Registered Bank or the Banking Group which would, if disclosed in this Disclosure Statement, materially adversely affect the decision of a person to subscribe for debt securities of which the Registered Bank or any member of the Banking Group is the issuer.

## Directorate

There have been no changes in the composition of the Bank's Board of Directors since 30 September 2010.

**Responsible Persons –** Messrs. John Anthony Waller, Non-Executive Director, Chairman, and Andrew Gregory Thorburn, Executive Director, have been authorised in writing to sign this Disclosure Statement in accordance with section 82 of the Reserve Bank of New Zealand Act 1989, on behalf of the other Directors, being:

Cameron Anthony Clyne

Prudence Mary Flacks

Edwin Gilmour Johnson

Dr Susan Carrel Macken

Stephen John Moir

Dr Andrew John Pearce

Michael James Ullmer

## Auditor

The auditor whose report is referred to in this Disclosure Statement is Ernst & Young. Their address for service is 2 Takutai Square, Britomart, Auckland 1010, New Zealand.

## Income Statement

*For the six months ended 31 March 2011*

| Dollars in Millions | Note | Consolidated Unaudited 6 Months 31/3/11 | Consolidated Unaudited 6 Months 31/3/10 | Consolidated Audited 12 Months 30/9/10 |
|---|---|---|---|---|
| Interest income | | **1,861** | 1,688 | 3,447 |
| Interest expense | | **1,186** | 1,066 | 2,166 |
| **Net interest income** | | **675** | 622 | 1,281 |
| Gains less losses on financial instruments at fair value | 2 | **(32)** | 30 | (18) |
| Other operating income | | **197** | 191 | 379 |
| **Total operating income** | | **840** | 843 | 1,642 |
| Operating expenses | | **382** | 404 | 818 |
| **Total operating profit before impairment losses on credit exposures and income tax expense** | | **458** | 439 | 824 |
| Impairment losses on credit exposures | 8 | **95** | 88 | 187 |
| **Total operating profit before income tax expense** | | **363** | 351 | 637 |
| Income tax expense on operating profit | | **108** | 103 | 202 |
| Income tax credit on New Zealand structured finance transactions | | **-** | (83) | (83) |
| Income tax credit interest costs on New Zealand structured finance transactions | | **-** | (84) | (84) |
| **Total income tax expense/(credit)** | | **108** | (64) | 35 |
| **Net profit attributable to shareholders of Bank of New Zealand** | | **255** | 415 | 602 |

*The accounting policies and other notes form part of, and should be read in conjunction with, these interim financial statements.*

## Statement of Comprehensive Income

*For the six months ended 31 March 2011*

| Dollars in Millions | Consolidated Unaudited 6 Months 31/3/11 | Consolidated Unaudited 6 Months 31/3/10 | Consolidated Audited 12 Months 30/9/10 |
|---|---|---|---|
| **Net profit attributable to shareholders of Bank of New Zealand** | **255** | 415 | 602 |
| **Other comprehensive (expense)/income, net of taxation** | | | |
| Net actuarial loss on defined benefit plan | **-** | - | (3) |
| Net change in foreign currency translation reserve | **(2)** | 2 | (6) |
| Net change in cash flow hedge reserve | **12** | 8 | 78 |
| Available for sale investments revaluation reserve: | | | |
| Change in available for sale investments revaluation reserve from revaluation | **1** | 12 | 6 |
| **Total other comprehensive income, net of taxation** | **11** | 22 | 75 |
| **Total comprehensive income attributable to shareholders of Bank of New Zealand** | **266** | 437 | 677 |

*The accounting policies and other notes form part of, and should be read in conjunction with, these interim financial statements.*

# Statement of Changes in Equity

*For the six months ended 31 March 2011*

| Dollars in Millions | Ordinary Capital | Perpetual Preference Capital | Retained Profits | Asset Revaluation Reserve | Foreign Currency Translation Reserve | Available For Sale Investments Revaluation Reserve | Cash Flow Hedge Reserve | Total Share-holders' Equity |
|---|---|---|---|---|---|---|---|---|
| **Consolidated 6 Months 31/3/11 Unaudited** | | | | | | | | |
| Balance at beginning of period | **1,451** | **910** | **1,566** | **2** | **(3)** | **16** | **60** | **4,002** |
| **Comprehensive income/ (expense)** | | | | | | | | |
| Net profit attributable to shareholders of Bank of New Zealand | **-** | **-** | **255** | **-** | **-** | **-** | **-** | **255** |
| Total other comprehensive (expense)/income | **-** | **-** | **-** | **-** | **(2)** | **1** | **12** | **11** |
| Total comprehensive income/ (expense) | **-** | **-** | **255** | **-** | **(2)** | **1** | **12** | **266** |
| Ordinary dividend | **-** | **-** | **(168)** | **-** | **-** | **-** | **-** | **(168)** |
| Perpetual preference dividend | **-** | **-** | **(30)** | **-** | **-** | **-** | **-** | **(30)** |
| Balance at end of period | **1,451** | **910** | **1,623** | **2** | **(5)** | **17** | **72** | **4,070** |
| 6 Months 31/3/10 Unaudited | | | | | | | | |
| Balance at beginning of period | 1,451 | 710 | 1,587 | 2 | 3 | 10 | (18) | 3,745 |
| **Comprehensive income** | | | | | | | | |
| Net profit attributable to shareholders of Bank of New Zealand | - | - | 415 | - | - | - | - | 415 |
| Total other comprehensive income | - | - | - | - | 2 | 12 | 8 | 22 |
| Total comprehensive income | - | - | 415 | - | 2 | 12 | 8 | 437 |
| Proceeds from shares issued | - | 200 | - | - | - | - | - | 200 |
| Ordinary dividend | - | - | (380) | - | - | - | - | (380) |
| Perpetual preference dividend | - | - | (27) | - | - | - | - | (27) |
| Balance at end of period | 1,451 | 910 | 1,595 | 2 | 5 | 22 | (10) | 3,975 |
| 12 Months 30/9/10 Audited | | | | | | | | |
| Balance at beginning of year | 1,451 | 710 | 1,587 | 2 | 3 | 10 | (18) | 3,745 |
| **Comprehensive income/ (expense)** | | | | | | | | |
| Net profit attributable to shareholders of Bank of New Zealand | - | - | 602 | - | - | - | - | 602 |
| Total other comprehensive (expense)/income | - | - | (3) | - | (6) | 6 | 78 | 75 |
| Total comprehensive income/ (expense) | - | - | 599 | - | (6) | 6 | 78 | 677 |
| Proceeds from shares issued | - | 200 | - | - | - | - | - | 200 |
| Ordinary dividend | - | - | (563) | - | - | - | - | (563) |
| Perpetual preference dividend | - | - | (57) | - | - | - | - | (57) |
| Balance at end of year | 1,451 | 910 | 1,566 | 2 | (3) | 16 | 60 | 4,002 |

*The accounting policies and other notes form part of, and should be read in conjunction with, these interim financial statements.*

# Balance Sheet

*As at 31 March 2011*

| Dollars in Millions | Note | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Audited 30/9/10 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with central banks | 4 | **1,566** | 1,995 | 2,040 |
| Due from other financial institutions | 5 | **1,035** | 780 | 1,249 |
| Trading securities | 6 | **3,431** | 3,221 | 3,231 |
| Other money market placements | | **333** | 276 | 433 |
| Available for sale investments | | **188** | 298 | 273 |
| Loans and advances to customers | 7 | **55,719** | 54,647 | 54,986 |
| Derivative financial instruments | | **4,588** | 4,770 | 5,650 |
| Amounts due from related entities | | **721** | 182 | 539 |
| Current tax | | **253** | 288 | 194 |
| Deferred tax | | **173** | 227 | 225 |
| Other assets | | **351** | 338 | 549 |
| Property, plant and equipment | | **177** | 149 | 161 |
| Goodwill and other intangible assets | | **133** | 97 | 117 |
| **Total assets** | | **68,668** | 67,268 | 69,647 |
| **Financed by:** | | | | |
| **Liabilities** | | | | |
| Due to central banks and other financial institutions | 10 | **875** | 1,786 | 1,575 |
| Other money market deposits | 11 | **10,104** | 10,850 | 11,883 |
| Trading liabilities | | **-** | 69 | 31 |
| Deposits from customers | 12 | **30,608** | 27,909 | 28,663 |
| Derivative financial instruments | | **5,187** | 5,489 | 6,421 |
| Bonds and notes | | **11,226** | 9,443 | 9,772 |
| Amounts due to related entities | | **4,484** | 5,839 | 5,137 |
| Other liabilities | | **836** | 630 | 885 |
| Subordinated debt | | **1,278** | 1,278 | 1,278 |
| **Total liabilities** | | **64,598** | 63,293 | 65,645 |
| **Net assets** | | **4,070** | 3,975 | 4,002 |
| **Shareholders' equity** | | | | |
| Contributed equity – ordinary shareholder | | **1,451** | 1,451 | 1,451 |
| Reserves | | **86** | 19 | 75 |
| Retained profits | | **1,623** | 1,595 | 1,566 |
| Ordinary shareholder's equity | | **3,160** | 3,065 | 3,092 |
| Contributed equity – perpetual preference shareholders | | **910** | 910 | 910 |
| **Total shareholders' equity** | | **4,070** | 3,975 | 4,002 |

*The accounting policies and other notes form part of, and should be read in conjunction with, these interim financial statements.*

# Cash Flow Statement

*For the six months ended 31 March 2011*

| Dollars in Millions | | Consolidated Unaudited 6 Months 31/3/11 | Unaudited 6 Months 31/3/10 | Audited 12 Months 30/9/10 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| **Cash was provided from:** | | | | |
| Dividend income | | **-** | - | 3 |
| Interest income | | **1,863** | 1,688 | 3,454 |
| Net trading income | | **76** | 41 | 26 |
| Other income | | **197** | 191 | 376 |
| **Cash was applied to:** | | | | |
| Interest expense | | **(1,184)** | (1,160) | (2,240) |
| Operating expenses | | **(376)** | (393) | (764) |
| **Net cash flows from operating activities before changes in operating assets and liabilities and income tax** | | **576** | 367 | 855 |
| **Changes in operating assets and liabilities arising from cash flow movements** | | | | |
| Net movement in balances with central banks (term)* | | **(27)** | (156) | (170) |
| Net movement in due from other financial institutions (term)* | | **(383)** | 23 | 172 |
| Net movement in loans and advances to customers* | | **(931)** | 291 | (179) |
| Net movement in other assets | | **197** | 248 | 30 |
| Net movement in other money market placements* | | **100** | 261 | 104 |
| Net movement in trading securities and trading liabilities* | | **(245)** | 507 | 475 |
| Net movement in deposits from customers* | | **1,945** | 676 | 1,430 |
| Net movement in due to central banks and other financial institutions (term)* | | **(660)** | (2,041) | (2,301) |
| Net movement in other liabilities | | **(49)** | (42) | 185 |
| **Net change in operating assets and liabilities** | | **(53)** | (233) | (254) |
| **Net cash flows from operating activities before income tax** | | **523** | 134 | 601 |
| **Cash was applied to:** | | | | |
| Taxes and subvention payments | | **(118)** | (171) | (150) |
| **Net cash flows from operating activities** | | **405** | (37) | 451 |
| **Cash flows from investing activities** | | | | |
| **Cash was provided from:** | | | | |
| Proceeds from sale of available for sale investments | | **-** | - | 47 |
| Proceeds on maturity of available for sale investments | | **83** | 50 | 50 |
| **Cash was applied to:** | | | | |
| Acquisition of intangible assets | | **(26)** | (15) | (42) |
| Purchase of available for sale investments | | **-** | - | (32) |
| Purchase of property, plant and equipment | | **(31)** | (23) | (62) |
| **Net cash flows from investing activities** | | **26** | 12 | (39) |
| **Cash flows from financing activities** | | | | |
| Net movement in bonds and notes* | | **1,668** | 1,835 | 1,975 |
| Net movement in derivative financial instruments* | | **(346)** | (897) | (631) |
| Net movement in other money market deposits* | | **(1,778)** | 73 | 1,102 |
| Net movement in related entity funding* | | **(835)** | (494) | (1,553) |
| Increase in contributed equity – perpetual preference shares | | **-** | 200 | 200 |
| Ordinary dividend | | **(168)** | (380) | (563) |
| Perpetual preference dividend | | **(30)** | (27) | (57) |
| **Net cash flows from financing activities** | | **(1,489)** | 310 | 473 |
| **Net (decrease)/increase in cash and cash equivalents** | | **(1,058)** | 285 | 885 |
| Cash and cash equivalents at beginning of period | | **2,103** | 1,218 | 1,218 |
| **Cash and cash equivalents at end of period** | | **1,045** | 1,503 | 2,103 |
| **Cash and cash equivalents at end of period comprised:** | | | | |
| Cash and balances with central banks (call) | 4 | **1,369** | 1,839 | 1,870 |
| Due from other financial institutions (call) | 5 | **80** | 59 | 677 |
| Due to central banks and other financial institutions (call) | 10 | **(404)** | (395) | (444) |
| **Total cash and cash equivalents** | | **1,045** | 1,503 | 2,103 |

* The amounts shown represent the net cash flows for the financial period.

## Cash Flow Statement *continued*

*For the six months ended 31 March 2011*

| Dollars in Millions | Note | Consolidated Unaudited 6 Months 31/3/11 | Unaudited 6 Months 31/3/10 | Audited 12 Months 30/9/10 |
|---|---|---|---|---|
| **Reconciliation of net profit attributable to shareholders of Bank of New Zealand to net cash flows from operating activities** | | | | |
| Net profit attributable to shareholders of Bank of New Zealand | | **255** | 415 | 602 |
| **Add back non-cash items in net profit:** | | | | |
| Decrease in accrued interest receivable | | **2** | - | 7 |
| Depreciation and amortisation expense | | **25** | 22 | 45 |
| Impairment losses on credit exposures | 8 | **95** | 88 | 187 |
| Impairment losses on non-financial assets | | **-** | 10 | - |
| Increase in accrued interest payable | | **2** | - | - |
| Loss on sale of property, plant and equipment | | **-** | 1 | 16 |
| Loss on disposal of intangible assets | | **-** | - | 9 |
| Unrealised gains less losses on financial instruments | | **108** | 11 | 44 |
| **Deduct non-cash items in net profit:** | | | | |
| Decrease in accrued interest payable | | **-** | (94) | (74) |
| Decrease in other operating provisions | | **(19)** | (22) | (16) |
| Decrease in provision for tax | | **(10)** | (235) | (115) |
| **Deduct operating cash flows not included in net profit:** | | | | |
| Net change in operating assets and liabilities | | **(53)** | (233) | (254) |
| **Net cash flows from operating activities** | | **405** | (37) | 451 |

### Netting of cash flows

Certain cash flows (as indicated by *) are shown net as these cash flows are received and disbursed on behalf of customers and counterparties and therefore reflect the activities of these parties rather than those of the Banking Group; or are received and disbursed in transactions where the turnover is quick, the amounts large and the maturities short.

Cash and cash equivalents consist of cash and short-term, highly liquid investments that are readily convertible to known amounts of cash and are subject to insignificant risk of changes in value and are held for the purpose of meeting short-term cash commitments.

Movements in cash and cash equivalents do not represent a cash inflow in the normal sense. Rather, they represent changes in the net inter-bank funding on the reporting dates. These balances fluctuate widely in the normal course of business.

*The accounting policies and other notes form part of, and should be read in conjunction with, these interim financial statements.*

## Notes to and Forming Part of the Interim Financial Statements

*For the six months ended 31 March 2011*

### Note 1 Principal Accounting Policies

These interim financial statements are general purpose financial reports prepared in accordance with the requirements of NZ IAS 34 Interim Financial Reporting and the Order, and should be read in conjunction with the General Disclosure Statement for the year ended 30 September 2010.

There have been no material changes in accounting policies during the interim financial period. The accounting policies used in the preparation of these interim financial statements are consistent with the accounting policies used in the preparation of the General Disclosure Statement for the year ended 30 September 2010.

#### Reclassification of financial information

Certain comparative balances have been reclassified to align with the presentation used in the current interim financial period. These reclassifications have no impact on the overall financial performance or financial position for the comparative reporting periods.

*Income Statement Notes*

| Dollars in Millions | **Consolidated Unaudited 6 Months 31/3/11** | Consolidated Unaudited 6 Months 31/3/10 | Consolidated Audited 12 Months 30/9/10 |
|---|---|---|---|
| **Note 2 Gains Less Losses on Financial Instruments at Fair Value** | | | |
| **Hedge accounting** | | | |
| Net gain arising from hedging instruments in fair value hedge accounting relationships | **23** | 13 | 10 |
| Net loss arising from the hedged items attributable to the hedged risk in fair value hedge accounting relationships | **(30)** | (43) | (47) |
| Ineffectiveness arising from cash flow hedge accounting relationships | **-** | (1) | (1) |
| | **(7)** | (31) | (38) |
| **Trading** | | | |
| Foreign exchange trading gain | **47** | 29 | 53 |
| Interest rate related trading derivatives | **16** | 47 | 10 |
| Net (loss)/gain in the fair value of financial assets and liabilities held for trading | **(4)** | 11 | 34 |
| | **59** | 87 | 97 |
| **Other** | | | |
| Net loss in the fair value of financial assets designated at fair value through profit or loss (refer to table below) | **(56)** | (36) | (81) |
| Net (loss)/gain in the fair value of financial liabilities designated at fair value through profit or loss (refer to table below) | **(32)** | 3 | 8 |
| Bid/offer adjustment | **(2)** | (4) | (2) |
| Net gain/(loss) attributable to other derivatives used for hedging purposes that do not qualify as designated and effective hedging instruments | **6** | 11 | (2) |
| | **(84)** | (26) | (77) |
| Total gains less losses on financial instruments at fair value | **(32)** | 30 | (18) |
| **Net loss in the fair value of financial assets comprised:** | | | |
| Loss in the fair value of financial assets designated at fair value through profit or loss | **(53)** | (42) | (72) |
| Credit risk adjustments on financial assets designated at fair value through profit or loss | **(21)** | (33) | (35) |
| Net gain attributable to other derivatives used for hedging purposes that do not use hedge accounting | **18** | 39 | 26 |
| | **(56)** | (36) | (81) |
| **Net (loss)/gain in the fair value of financial liabilities comprised:*** | | | |
| Gain/(loss) in the fair value of financial liabilities designated at fair value through profit or loss | **191** | (12) | (166) |
| Credit value adjustments on financial liabilities designated at fair value through profit or loss | **9** | - | 4 |
| Net (loss)/gain attributable to other derivatives used for hedging purposes that do not use hedge accounting | **(232)** | 15 | 170 |
| | **(32)** | 3 | 8 |

* All foreign currency gains/(losses) are excluded from this category. Due to the Banking Group's practice of managing all foreign currency risk centrally, all foreign currency gains/(losses) are included within 'Foreign exchange trading gain' above.

## Note 3 Segment Analysis

### Operating segments

An operating segment is a component of an entity engaging in business activities and whose operating results are regularly reviewed by the entity's chief operating decision maker. For each operating segment identified by the Banking Group, financial information is regularly reported to the New Zealand Leadership Team for the purposes of evaluation of performance and allocation of resource.

The Banking Group's business is organised into two operating and reportable segments: Retail and BNZ Partners. Retail provides financial services and products to individual customers and, for management reporting purposes, includes insurance activities carried out by a controlled entity of National Australia Bank Limited that is not part of the Banking Group. BNZ Partners provides financial services and products to business, agribusiness and corporate customers.

Segment profit represents operating profit before unrealised fair value gains or losses on financial instruments and income or expenses which are one-off in nature and are not part of the Banking Group's core business operations.

Revenues and expenses directly associated with each operating segment are included in determining their result. Transactions between operating segments are based on agreed recharges between segments. Segment revenue represents revenue directly attributable to a segment and a portion of the Banking Group's revenue that can be allocated to a segment on a reasonable basis. Segment revenue includes Net interest income and Other operating income, and includes transfer pricing adjustments to reflect intersegment funding arrangements. Intersegment pricing is determined on an arm's length basis.

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

| | **Consolidated** | | | | |
|---|---|---|---|---|---|
| | **6 Months 31/3/11 Unaudited** | | | | |
| Dollars in Millions | **Retail** | **BNZ Partners** | **Total Reportable Segments** | **Other** | **Total Banking Group** |
| Revenue from external customers | **378** | **504** | **882** | **(42)** | **840** |
| Net inter-segment revenue | **1** | **39** | **40** | **(40)** | **-** |
| Total segment revenue | **379** | **543** | **922** | **(82)** | **840** |
| Profit before income tax expense* | **176** | **279** | **455** | **(92)** | **363** |
| Total income tax expense | **49** | **84** | **133** | **(25)** | **108** |
| Net profit attributable to shareholders of Bank of New Zealand | **127** | **195** | **322** | **(67)** | **255** |
| | 6 Months 31/3/10 Unaudited | | | | |
| Revenue from external customers | 350 | 484 | 834 | 9 | 843 |
| Net inter-segment revenue | 1 | 33 | 34 | (34) | - |
| Total segment revenue | 351 | 517 | 868 | (25) | 843 |
| Profit before income tax expense* | 154 | 255 | 409 | (58) | 351 |
| Income tax expense | 42 | 76 | 118 | (15) | 103 |
| Income tax credit on New Zealand structured finance transactions | - | - | - | (83) | (83) |
| Income tax credit interest costs on New Zealand structured finance transactions | - | - | - | (84) | (84) |
| Total income tax expense /(credit) | 42 | 76 | 118 | (182) | (64) |
| Net profit attributable to shareholders of Bank of New Zealand | 112 | 179 | 291 | 124 | 415 |
| | 12 Months 30/9/10 Audited | | | | |
| Revenue from external customers | 722 | 990 | 1,712 | (70) | 1,642 |
| Net inter-segment revenue | 2 | 73 | 75 | (75) | - |
| Total segment revenue | 724 | 1,063 | 1,787 | (145) | 1,642 |
| Profit before income tax expense* | 300 | 582 | 882 | (245) | 637 |
| Income tax expense | 83 | 175 | 258 | (56) | 202 |
| Income tax credit on New Zealand structured finance transactions | - | - | - | (83) | (83) |
| Income tax credit interest costs on New Zealand structured finance transactions | - | - | - | (84) | (84) |
| Total income tax expense/(credit) | 83 | 175 | 258 | (223) | 35 |
| Net profit attributable to shareholders of Bank of New Zealand | 217 | 407 | 624 | (22) | 602 |

* For the six months ended 31 March 2011, profit before income tax expense in the Other category includes fair value losses on financial instruments of $100 million (six months ended 31 March 2010: $110 million; year ended 30 September 2010: $94 million).

Notes to and Forming Part of the Interim Financial Statements *continued*

*Asset Notes*

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Audited 30/9/10 |
|---|---|---|---|
| **Note 4 Cash and Balances With Central Banks** | | | |
| Notes and coins | **139** | 164 | 120 |
| Transaction balances with central banks | **1,230** | 1,675 | 1,750 |
| Loans and advances to central banks | **197** | 156 | 170 |
| Total cash and balances with central banks | **1,566** | 1,995 | 2,040 |
| **Cash and balances with central banks comprised:** | | | |
| Call balances | **1,369** | 1,839 | 1,870 |
| Term balances | **197** | 156 | 170 |
| Total cash and balances with central banks | **1,566** | 1,995 | 2,040 |

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Audited 30/9/10 |
|---|---|---|---|
| **Note 5 Due from Other Financial Institutions** | | | |
| Transaction balances with other financial institutions | **80** | 59 | 677 |
| Securities purchased under agreements to resell with other financial institutions | **155** | 226 | 88 |
| Loans and advances due from other financial institutions | **800** | 495 | 484 |
| Total due from other financial institutions | **1,035** | 780 | 1,249 |
| **Due from other financial institutions comprised:** | | | |
| Call balances | **80** | 59 | 677 |
| Term balances | **955** | 721 | 572 |
| Total due from other financial institutions | **1,035** | 780 | 1,249 |

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Audited 30/9/10 |
|---|---|---|---|
| **Note 6 Trading Securities** | | | |
| Treasury bills | **1,481** | 965 | 1,267 |
| Government securities | **1,186** | 620 | 974 |
| Semi-government securities | **75** | 60 | 145 |
| Bank bills | **70** | 1,366 | 263 |
| Bank bonds | **318** | 120 | 382 |
| Promissory notes | **223** | 55 | 171 |
| Other securities | **78** | 35 | 29 |
| Total trading securities | **3,431** | 3,221 | 3,231 |

Included in trading securities as at 31 March 2011 were $22 million encumbered through repurchase agreements (31 March 2010: $175 million; 30 September 2010: $600 million). No trading securities were used to secure deposit obligations as at 31 March 2011 (31 March 2010: nil; 30 September 2010: nil).

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Audited 30/9/10 |
|---|---|---|---|
| **Note 7 Loans and Advances to Customers** | | | |
| Overdrafts | **2,199** | 2,168 | 2,185 |
| Credit card outstandings | **1,382** | 1,348 | 1,369 |
| Lease finance | **22** | 28 | 24 |
| Housing loans | **26,743** | 25,779 | 26,262 |
| Other term lending | **25,664** | 25,604 | 25,388 |
| Other lending | **162** | 102 | 149 |
| Total gross loans and advances to customers | **56,172** | 55,029 | 55,377 |
| **Deduct:** | | | |
| Allowance for impairment losses and credit risk adjustments on individual financial assets (refer to table below) | **260** | 249 | 242 |
| Allowance for impairment losses and credit risk adjustments on groups of financial assets (refer to table below) | **293** | 263 | 273 |
| Unearned future income on lease finance | **3** | 5 | 4 |
| Deferred income | **37** | 39 | 41 |
| Fair value hedge adjustments | **(140)** | (174) | (169) |
| Total deductions | **453** | 382 | 391 |
| Total net loans and advances to customers | **55,719** | 54,647 | 54,986 |
| **Allowance for impairment losses and credit risk adjustments comprised:** | | | |
| **Individual financial assets** | | | |
| Allowance for impairment losses on loans and advances to customers | **176** | 147 | 148 |
| Credit risk adjustments on loans designated at fair value through profit or loss | **84** | 102 | 94 |
| | **260** | 249 | 242 |
| **Groups of financial assets** | | | |
| Allowance for impairment losses on loans and advances to customers | **219** | 188 | 203 |
| Credit risk adjustments on loans designated at fair value through profit or loss | **74** | 75 | 70 |
| | **293** | 263 | 273 |

The BNZ RMBS Trust Series 2008-1 (the "RMBS Trust") provides an in-house residential mortgage-backed securities facility to issue securities as collateral for borrowing from the Reserve Bank of New Zealand ("RBNZ"). As at 31 March 2011, included within the Banking Group's loans and advances to customers were housing loans to the value of $4,462 million held by the RMBS Trust (31 March 2010: $6,462 million; 30 September 2010: $4,467 million). These housing loans have not been derecognised from the Banking Group's financial statements as the Banking Group retains substantially all of the risks and rewards of ownership. The Banking Group had not entered into any repurchase agreements for residential mortgage-backed securities with the RBNZ as at 31 March 2011 (31 March 2010: $600 million; 30 September 2010: nil). RBNZ had not accepted any residential mortgage-backed securities as collateral from the Banking Group as at 31 March 2011 (31 March 2010: $735 million; 30 September 2010: nil).

On 2 June 2010, the BNZ Covered Bond Trust (the "Covered Bond Trust") was established to hold Bank of New Zealand housing loans, and its trustee provides guarantees of the covered bonds issued by the Bank or BNZ International Funding Limited (London Branch), a wholly owned controlled entity of the Bank. Guarantees provided in relation to the covered bonds issued have a prior claim over the assets of the Trust. As at 31 March 2011, included within the Banking Group's loans and advances to customers were housing loans to the value of $2,952 million held by the Covered Bond Trust (31 March 2010: nil; 30 September 2010: $489 million). These housing loans have not been derecognised from the Banking Group's financial statements as the Banking Group retains substantially all of the risks and rewards of ownership. The Banking Group had issued debt securities with a face value of $2,586 million that were guaranteed by the Covered Bond Trust as at 31 March 2011 (31 March 2010: nil; 30 September 2010: $425 million). The underlying collateral for the guarantees provided by the Covered Bond Trust comprised housing loans and other assets to the value of $2,986 million as at 31 March 2011 (31 March 2010: nil; 30 September 2010: $493 million).

# Notes to and Forming Part of the Interim Financial Statements *continued*

| Dollars in Millions | Consolidated Residential Mortgage Lending Unaudited 31/3/11 | Consolidated Other Retail Exposures Unaudited 31/3/11 | Consolidated Corporate Exposures Unaudited 31/3/11 | Consolidated Total Unaudited 31/3/11 |
|---|---|---|---|---|
| **Note 8 Allowance for Impairment Losses on Credit Exposures** | | | | |
| **Allowance for impairment losses on credit exposures** | | | | |
| **Allowance for impairment losses on individual financial assets** | | | | |
| **Loans and advances to customers** | | | | |
| Balance at beginning of period | 53 | 21 | 74 | 148 |
| Charge to impairment losses on credit exposures in income statement | 11 | 21 | 47 | 79 |
| Amounts written off | (9) | (23) | (23) | (55) |
| Recovery of amounts written off in previous periods | - | 4 | - | 4 |
| Balance at end of period | 55 | 23 | 98 | 176 |
| **Allowance for impairment losses on groups of financial assets** | | | | |
| **Loans and advances to customers** | | | | |
| Balance at beginning of period | 31 | 72 | 100 | 203 |
| Charge to impairment losses on credit exposures in income statement | 8 | 2 | 6 | 16 |
| Balance at end of period | 39 | 74 | 106 | 219 |
| Total allowance for impairment losses on credit exposures | 94 | 97 | 204 | 395 |

The above table only reflects allowances for impairment losses on financial assets held at amortised cost. Credit risk adjustments on financial assets designated at fair value through profit or loss have been incorporated into the carrying value of those assets and charged to the income statement within Gains less losses on financial instruments at fair value.

The changes in value of financial assets designated at fair value through profit or loss that is attributable to changes in credit risk have been calculated using a statistical-based calculation that estimates expected losses attributable to adverse movement in credit risks.

Credit risk adjustments on financial assets designated at fair value through profit or loss are analysed in the table below.

| Dollars in Millions | Consolidated Residential Mortgage Lending Unaudited 31/3/11 | Consolidated Other Retail Exposures Unaudited 31/3/11 | Consolidated Corporate Exposures Unaudited 31/3/11 | Consolidated Total Unaudited 31/3/11 |
|---|---|---|---|---|
| **Credit risk adjustments on financial assets designated at fair value through profit or loss** | | | | |
| **On individual financial assets** | | | | |
| **Loans and advances to customers** | | | | |
| Balance at beginning of period | - | - | 94 | 94 |
| Charge to income statement | - | - | 18 | 18 |
| Amounts written off | - | - | (28) | (28) |
| Balance at end of period | - | - | 84 | 84 |
| **On groups of financial assets** | | | | |
| **Loans and advances to customers** | | | | |
| Balance at beginning of period | - | 1 | 69 | 70 |
| Charge to income statement | - | - | 4 | 4 |
| Balance at end of period | - | 1 | 73 | 74 |
| Total credit risk adjustments on loans and advances designated at fair value through profit or loss | - | 1 | 157 | 158 |
| **Other money market placements** | | | | |
| Balance at beginning of period | - | - | 1 | 1 |
| Charge to income statement | - | - | (1) | (1) |
| Balance at end of period | - | - | - | - |
| Total credit risk adjustments on other money market placements | - | - | - | - |
| **Trading derivative financial instruments** | | | | |
| Balance at beginning of period | - | - | 9 | 9 |
| Charge to income statement | - | - | - | - |
| Balance at end of period | - | - | 9 | 9 |
| Total credit risk adjustments on trading derivative financial instruments | - | - | 9 | 9 |

## Note 9 Asset Quality

The Banking Group provides for impairment losses on credit exposures as disclosed in note 8. Accordingly, when management determines that recovery of a loan is doubtful, the principal amount and accrued interest on the obligation are written down to estimated net realisable value.

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Residential Mortgage Lending Unaudited 31/3/11 | Other Retail Exposures Unaudited 31/3/11 | Corporate Exposures Unaudited 31/3/11 | Total Unaudited 31/3/11 |
| **Movements in pre-allowance balances** | | | | |
| **Loans and advances to customers** | | | | |
| **Restructured assets** | | | | |
| Balance at beginning of period | 1 | 2 | - | 3 |
| Additions | - | 1 | 32 | 33 |
| Deletions | (1) | (1) | - | (2) |
| Balance at end of period | - | 2 | 32 | 34 |
| **Other individually impaired assets – at amortised cost** | | | | |
| Balance at beginning of period | 161 | 34 | 292 | 487 |
| Amounts written off | (9) | (23) | (23) | (55) |
| Additions | 68 | 35 | 182 | 285 |
| Deletions | (64) | (11) | (91) | (166) |
| Balance at end of period | 156 | 35 | 360 | 551 |
| Allowance for impairment losses on individual financial assets | 55 | 23 | 98 | 176 |
| Undrawn lending commitments | - | - | 3 | 3 |
| **Other individually impaired assets – at fair value through profit or loss** | | | | |
| Balance at beginning of period | - | - | 282 | 282 |
| Amounts written off | - | - | (28) | (28) |
| Additions | - | - | 87 | 87 |
| Deletions | - | - | (96) | (96) |
| Balance at end of period | - | - | 245 | 245 |
| Credit risk adjustments on financial assets designated at fair value through profit or loss – On individual financial assets | - | - | 84 | 84 |
| Undrawn lending commitments | - | - | - | - |
| Total impaired assets at end of period | 156 | 37 | 637 | 830 |
| **Other assets under administration** | | | | |
| Balance at end of period | 7 | 1 | 2 | 10 |

**Off-balance sheet impaired assets**

Included in contingent liabilities in note 14 on page 15 is $6 million off-balance sheet facilities that were impaired as at 31 March 2011. No allowance for impairment losses on individual off-balance sheet credit related commitments had been made as at 31 March 2011.

**Credit quality of financial assets**

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Residential Mortgage Lending Unaudited 31/3/11 | Other Retail Exposures Unaudited 31/3/11 | Corporate Exposures Unaudited 31/3/11 | Total Unaudited 31/3/11 |
| **Past due assets not impaired** | | | | |
| **Loans and advances to customers** | | | | |
| 1 - 7 days past due | 171 | 70 | 445 | 686 |
| 8 - 29 days past due | 109 | 89 | 105 | 303 |
| 1 - 29 days past due | 280 | 159 | 550 | 989 |
| 30 - 59 days past due | 97 | 36 | 85 | 218 |
| 60 - 89 days past due | 45 | 14 | 15 | 74 |
| 90+ days past due | 93 | 41 | 129 | 263 |
| | 515 | 250 | 779 | 1,544 |
| **Other money market placements** | | | | |
| 1 - 7 days past due | - | - | 1 | 1 |
| **Total past due assets not impaired** | 515 | 250 | 780 | 1,545 |

The credit quality of assets that are neither past due nor impaired has been classified using the Banking Group's internal customer rating system and credit monitoring procedures required under internal policies, and in accordance with the Basel II Accord (refer to note17).

*Liability Notes*

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Consolidated Unaudited 31/3/10 | Consolidated Audited 30/9/10 |
|---|---|---|---|
| **Note 10 Due to Central Banks and Other Financial Institutions** | | | |
| Transaction balances with other financial institutions | **404** | 395 | 444 |
| Deposits from central banks | **29** | 290 | 29 |
| Deposits from other financial institutions | **420** | 327 | 448 |
| Securities sold under agreements to repurchase from central banks | **-** | 600 | - |
| Securities sold under agreements to repurchase from other financial institutions | **22** | 174 | 654 |
| Total due to central banks and other financial institutions | **875** | 1,786 | 1,575 |
| **Due to central banks and other financial institutions comprised:** | | | |
| Call balances | **404** | 395 | 444 |
| Term balances | **471** | 1,391 | 1,131 |
| Total due to central banks and other financial institutions | **875** | 1,786 | 1,575 |

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Consolidated Unaudited 31/3/10 | Consolidated Audited 30/9/10 |
|---|---|---|---|
| **Note 11 Other Money Market Deposits** | | | |
| Money market deposits from non-financial institutions | **2,454** | 2,444 | 2,853 |
| Certificates of deposit | **2,269** | 2,805 | 1,752 |
| Commercial paper | **5,381** | 5,601 | 7,278 |
| Total other money market deposits | **10,104** | 10,850 | 11,883 |

| Dollars in Millions | Consolidated Unaudited 31/3/11 | Consolidated Unaudited 31/3/10 | Consolidated Audited 30/9/10 |
|---|---|---|---|
| **Note 12 Deposits from Customers** | | | |
| Demand deposits not bearing interest | **905** | 695 | 801 |
| Demand deposits bearing interest | **11,196** | 10,449 | 10,302 |
| Term deposits | **18,507** | 16,765 | 17,560 |
| Total deposits from customers | **30,608** | 27,909 | 28,663 |

| Dollars in Millions | Consolidated Unaudited 31/3/11 |
|---|---|
| **Note 13 Interest Earning and Discount Bearing Assets and Liabilities** | |
| Interest earning and discount bearing assets | **62,423** |
| Interest and discount bearing liabilities | **57,579** |

## Note 14 Contingent Liabilities and Credit Related Commitments

Bank of New Zealand and other income tax group members have a joint and several liability for the income tax liability of the income tax group. Bank of New Zealand is not expected to incur any additional tax liability as a result of this joint and several liability.

Contingent liabilities and credit commitments exist in respect of commitments to extend credit, letters of credit and financial guarantees, as well as claims, potential claims and court proceedings against entities in the Banking Group. Any potential liability arising in respect of these claims cannot be accurately assessed. Where some loss is probable appropriate provisions have been made.

On 31 July 2006, the Bank sold 100% of the share capital in Custom Fleet (NZ) Limited. The Bank provided limited indemnities regarding certain sale-related warranties and the performance of Custom Fleet (NZ) Limited prior to 31 July 2006. These indemnities are valid for a period of not longer than seven years from the date of sale.

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

| | Consolidated | | |
|---|---|---|---|
| Dollars in Millions | **Unaudited 31/3/11** | Unaudited 31/3/10 | Audited 30/9/10 |
| **Contingent liabilities** | | | |
| Bank guarantees | **53** | 53 | 52 |
| Standby letters of credit | **332** | 362 | 342 |
| Documentary letters of credit | **73** | 79 | 91 |
| Performance related contingencies | **328** | 314 | 331 |
| Total contingent liabilities | **786** | 808 | 816 |
| **Credit related commitments** | | | |
| Revocable commitments to extend credit | **5,079** | 4,968 | 4,995 |
| Irrevocable commitments to extend credit | **7,151** | 7,779 | 6,960 |
| Total credit related commitments | **12,230** | 12,747 | 11,955 |
| Total contingent liabilities and credit related commitments | **13,016** | 13,555 | 12,771 |

## Note 15 Concentrations of Credit Exposures to Individual Counterparties and Groups of Closely Related Counterparties

The Banking Group's disclosure of concentrations of credit exposures to individual counterparties and groups of closely related counterparties is based on actual credit exposures and excludes credit exposures to connected persons, the central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, and banks with a long-term credit rating of A- or A3 or above, or its equivalent. Peak credit exposures to individual counterparties are calculated using the Banking Group's end of period shareholders' equity.

As at 31 March 2011 and for the three months ended 31 March 2011, the Banking Group has no bank or non-bank counterparties that equals or exceeds 10% of the Banking Group's equity and meets the disclosure thresholds described above.

## Note 16 Insurance Business, Securitisation, Funds Management, Other Fiduciary Activities, and the Marketing and Distribution of Insurance Products

### Securitisation activities

During the three months ended 31 March 2011, Bank of New Zealand issued a NZ$300 million (face value) registered transferable note with a coupon of 3 month NZD BKBM + 127bp (floating) and maturity date of 31 March 2019. This note is guaranteed by the Covered Bond Trust. Further details on the Covered Bond Trust are provided in note 7.

### Insurance business

The Banking Group does not conduct any Insurance Business, as defined in clause 3(a) of Bank of New Zealand's conditions of registration.

## Note 17 Capital Adequacy

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

### RBNZ Capital Adequacy Framework (Internal Models Based Approach)

The Banking Group has calculated its implied Risk-Weighted Exposure and minimum regulatory capital requirements based on the RBNZ's Capital Adequacy Framework (Internal Models Based Approach) ("BS2B") for operational risk and the majority of credit risk portfolios.

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

The exceptions to the Internal Ratings Based Approach for Credit Risk are portfolios of relatively low materiality which are subject to the standardised treatment as set out in the RBNZ's Capital Adequacy Framework (Standardised Approach) ("BS2A").

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

### Capital management policies

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

The Banking Group's conditions of registration require capital adequacy ratios to be calculated in accordance with BS2B dated October 2010. For regulatory capital adequacy purposes, capital comprises two elements, Tier One and Tier Two capital, from which certain deductions are made to arrive at eligible Tier One and Tier Two capital. Tier One capital includes paid up ordinary shares, perpetual preference shares, retained profits less intangible assets and certain other deductions. Tier Two capital is divided into two levels. Upper Tier Two capital consists of revaluation reserves and perpetual subordinated debt while lower Tier Two capital consists of term subordinated debt and other qualifying capital instruments. Tier Two capital is limited to 100% of Tier One capital. Lower Tier Two capital is limited to 50% of Tier One capital.

The Banking Group is required under its conditions of registration to maintain a minimum ratio of total eligible or qualifying capital to total risk-weighted assets of 8%, of which a minimum of 4% must be held in Tier One capital.

The Banking Group has an Internal Capital Adequacy Assessment Process in place which complies with the requirements set out in the RBNZ's "Guidelines on a Bank's Internal Capital Adequacy Assessment Process ("ICAAP")" ("BS12") as specified under the Banking Group's conditions of registration. The Banking Group's ICAAP outlines the approach to maintaining capital adequacy, risk appetite and stress testing. The ICAAP considers all material risks consistent with the Banking Group's risk appetite and outlines the capital requirements.

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

For more information on the capital structure of the Banking Group, refer to page 25.

## Note 17 Capital Adequacy *continued*

The tables included below and on the following pages detail the capital calculation, capital ratios and risk-weighted assets as at 31 March 2011. During the interim financial period the Banking Group fully complied with all RBNZ's capital requirements as set out in the Banking Group's conditions of registration.

### Regulatory capital

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

| Dollars in Millions | Consolidated Unaudited 31/3/11 |
|---|---|
| **Qualifying capital** | |
| **Tier One capital** | |
| Contributed equity – ordinary shareholder | 1,451 |
| Contributed equity – perpetual preference shareholders | 910 |
| Retained profits | 1,623 |
| Deductions from Tier One capital: | |
| Intangible assets | 133 |
| Credit value adjustment on liabilities designated at fair value through profit or loss | 30 |
| Prepaid pension assets (net of deferred tax) | 3 |
| 50% of total expected loss less total eligible allowances for impairment | 54 |
| Total Tier One capital | 3,764 |
| **Upper Tier Two capital** | |
| Revaluation reserves | 14 |
| Subordinated loans from related entities | 190 |
| Total upper Tier Two capital | 204 |
| **Lower Tier Two capital** | |
| Subordinated loans from related entities | 715 |
| Other subordinated debt | 373 |
| Total lower Tier Two capital | 1,088 |
| Deductions from Tier Two capital: | |
| 50% of total expected loss less total eligible allowances for impairment | 54 |
| Total Tier Two capital | 1,238 |
| Total Tier One and Tier Two qualifying capital | 5,002 |

### Basel II regulatory capital ratios

The table below shows the capital adequacy ratios based on BS2B.

| | Regulatory Minima | Consolidated Unaudited 31/3/11 | Unaudited 31/3/10 | Unaudited 30/9/10 |
|---|---|---|---|---|
| Tier One capital expressed as a percentage of total risk-weighted exposures | 4.00% | 8.49% | 9.03% | 8.85% |
| Total qualifying capital expressed as a percentage of total risk-weighted exposures | 8.00% | 11.29% | 12.03% | 11.81% |

### Total regulatory capital requirements

| Dollars in Millions | Consolidated Total Exposure at Default Unaudited 31/3/11 | Risk-Weighted Exposure or Implied Risk-Weighted Exposure Unaudited 31/3/11 | Total Capital Requirement Unaudited 31/3/11 |
|---|---|---|---|
| **Credit risk** | | | |
| Exposures subject to the internal ratings based approach | 72,147 | 33,556 | 2,685 |
| Equity exposures | 41 | 137 | 11 |
| Specialised lending subject to the slotting approach | 3,532 | 3,125 | 251 |
| Exposures subject to the standardised approach | 1,431 | 1,145 | 92 |
| Total credit risk | 77,151 | 37,963 | 3,039 |
| **Operational risk** | N/A | 3,995 | 320 |
| **Market risk** | N/A | 2,364 | 189 |
| **Total** | N/A | 44,322 | 3,548 |

RBNZ has removed the requirement for the supervisory adjustment that related to residential mortgage risk weights due to the approval by RBNZ to use the Banking Group's internal residential mortgage PD model.

## Note 17 Capital Adequacy *continued*

### Basel I regulatory capital ratios

The table below shows the capital adequacy ratios based on the RBNZ's Basel I Capital Adequacy Framework ("BS2").

| | The Registered Bank | | |
|---|---|---|---|
| | **Unaudited 31/3/11** | Unaudited 31/3/10 | Audited 30/9/10 |
| Tier One capital expressed as a percentage of total risk-weighted exposures | **8.12%** | 8.30% | 8.08% |
| Total qualifying capital expressed as a percentage of total risk-weighted exposures | **10.80%** | 11.08% | 10.78% |

For the purposes of calculating capital adequacy ratios for the Banking Group (the "Registered Bank") under Basel I, subsidiaries which are both wholly owned and wholly funded by the Registered Bank are consolidated within the Registered Bank.

### Advanced Internal Ratings Based approach to credit risk management

The Banking Group's quantitative credit risk measurement is based on the Internal Ratings Based ("IRB") approach (IRB for Retail Credit portfolios and Advanced IRB for Non-retail Credit portfolios) and uses a series of models, to calculate loss estimates for the credit portfolio. This includes consideration of:

- probability of default ("PD") which estimates the probability that a loan or group of loans will become delinquent over the next 12 months;
- exposure at time of default ("EAD") which estimates the amount of outstanding principal, fees and interest owed at the time of default; and
- loss given default ("LGD") which estimates the expected loss in the event of default. It is the percentage of exposure which will be lost after all recovery efforts, including legal expenses, time value of money and recovery expenses.

The above three elements (PD, EAD, LGD) are important inputs in determining the risk-weighted exposure calculations for both on and off-balance sheet exposures, including undrawn portions of credit facilities, committed and contingent exposures. These ratings are also an important input into the credit approval, risk management, internal capital allocation and corporate governance functions of the Banking Group.

Methodologies used to calculate credit risk estimates (PD, EAD and LGD) are in accordance with BS2B and the Banking Group's conditions of registration. For credit risk estimates on some portfolios, the RBNZ has set prescribed risk estimates required to be used when calculating risk-weighted assets and capital under BS2B. The RBNZ prescribed risk estimates will continue to be used until the Banking Group develops its own internal models for these portfolios.

### Controls surrounding credit risk rating systems

The credit risk rating systems cover all methods, processes, controls, data collection and technology that support the assessment of credit risk, the assignment of internal credit risk ratings and the quantification of associated default and loss estimates.

The credit risk rating systems and risk estimate processes are governed by the Banking Group's Credit Risk Committee and are an integral part of reporting to senior management. Management and staff of the credit risk function regularly assess the performance of the rating systems, monitor progress on changes being made to systems and identify any areas for improvement. These systems are subject to rigorous internal review and approval and regular independent review. The annual validation of models is undertaken by specialists who are responsible for overseeing the design, implementation and performance of all rating models in the Banking Group.

The risk-weighted asset amounts presented in the following tables include a scalar of 1.06 as required by the RBNZ in accordance with the Banking Group's conditions of registration.

## Note 17 Capital Adequacy *continued*

### Credit risk subject to the Internal Ratings Based ("IRB") approach

The following tables analyse credit risk exposures by asset class split into PD bandings. (The lower the PD banding the less the probability of default over the next 12 months).

| | Consolidated | | | | | |
|---|---|---|---|---|---|---|
| Dollars in Millions | Weighted Average PD (%) Unaudited 31/3/11 | Exposure at Default Unaudited 31/3/11 | Exposure-Weighted LGD used for the Capital Calculation (%) Unaudited 31/3/11 | Exposure-Weighted Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Capital Requirement Unaudited 31/3/11 |
| **Corporate** | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.06 | 3,465 | 53 | 23 | 783 | 63 |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.29 | 8,675 | 37 | 39 | 3,345 | 267 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 0.98 | 7,733 | 33 | 60 | 4,611 | 369 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 2.61 | 9,351 | 36 | 86 | 8,047 | 644 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | 8.22 | 983 | 39 | 127 | 1,252 | 100 |
| Default PD grade = 100% | 100.00 | 967 | 48 | 328 | 3,173 | 254 |
| Total corporate exposures | 4.47 | 31,174 | 38 | 68 | 21,211 | 1,697 |
| **Sovereign** | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.01 | 3,881 | 5 | 1 | 40 | 3 |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.42 | 7 | 45 | 62 | 4 | - |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 1.14 | 10 | 45 | 91 | 9 | 1 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 3.16 | 22 | 45 | 139 | 31 | 3 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | - | - | - | - | - | - |
| Default PD grade = 100% | - | - | - | - | - | - |
| Total sovereign exposures | 0.03 | 3,920 | 5 | 2 | 84 | 7 |
| **Bank** | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.05 | 2,632 | 35 | 9 | 246 | 20 |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.43 | 157 | 57 | 73 | 114 | 9 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 1.01 | 14 | 61 | 105 | 15 | 1 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 2.88 | - | 20 | 57 | - | - |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | - | - | - | - | - | - |
| Default PD grade = 100% | - | - | - | - | - | - |
| Total bank exposures | 0.08 | 2,803 | 36 | 13 | 375 | 30 |
| **Residential mortgage**[1] | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.03 | - | 38 | 4 | - | - |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.39 | 1,819 | 17 | 11 | 208 | 17 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 0.92 | 24,618 | 21 | 26 | 6,500 | 520 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 4.92 | 2,650 | 19 | 67 | 1,776 | 142 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | - | - | - | - | - | - |
| Default PD grade = 100% | 100.00 | 353 | 28 | 217 | 767 | 61 |
| Total residential mortgage exposures | 2.43 | 29,440 | 21 | 31 | 9,251 | 740 |

1. RBNZ has approved calibration changes to the model for calculating credit risk exposures for residential mortgages. This has resulted in changes to the PD grade spread.

## Note 17 Capital Adequacy *continued*

### Credit risk subject to the Internal Ratings Based ("IRB") approach *continued*

| Dollars in Millions | Weighted Average PD (%) Unaudited 31/3/11 | Exposure at Default Unaudited 31/3/11 | Exposure-Weighted LGD used for the Capital Calculation (%) Unaudited 31/3/11 | Exposure-Weighted Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Capital Requirement Unaudited 31/3/11 |
|---|---|---|---|---|---|---|
| | Consolidated | | | | | |
| **Other retail**[1] | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.05 | 862 | 85 | 13 | 115 | 9 |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.24 | 700 | 83 | 39 | 270 | 22 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 0.97 | 435 | 83 | 87 | 377 | 30 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 2.88 | 412 | 83 | 120 | 495 | 40 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | 15.41 | 217 | 82 | 157 | 340 | 27 |
| Default PD grade = 100% | 100.00 | 25 | 74 | 500 | 124 | 10 |
| Total other retail exposures | 2.89 | 2,651 | 84 | 65 | 1,721 | 138 |
| **Retail SME**[2] | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.08 | 67 | 22 | 5 | 3 | - |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.37 | 195 | 26 | 16 | 31 | 2 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 1.04 | 753 | 27 | 30 | 224 | 18 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 2.68 | 950 | 31 | 44 | 420 | 34 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | 8.32 | 114 | 33 | 57 | 65 | 5 |
| Default PD grade = 100% | 100.00 | 80 | 44 | 214 | 171 | 14 |
| Total retail SME exposures | 5.73 | 2,159 | 30 | 42 | 914 | 73 |
| **Total** | | | | | | |
| Exposure-weighted PD grade > 0 ≤ 0.1% | 0.04 | 10,907 | 34 | 11 | 1,187 | 95 |
| Exposure-weighted PD grade > 0.1 ≤ 0.5% | 0.30 | 11,553 | 37 | 34 | 3,972 | 317 |
| Exposure-weighted PD grade > 0.5 ≤ 1.5% | 0.94 | 33,563 | 25 | 35 | 11,736 | 939 |
| Exposure-weighted PD grade > 1.5 ≤ 5.0% | 3.08 | 13,385 | 34 | 80 | 10,769 | 863 |
| Exposure-weighted PD grade > 5.0 ≤ 99.99% | 9.42 | 1,314 | 46 | 126 | 1,657 | 132 |
| Default PD grade = 100% | 100.00 | 1,425 | 43 | 297 | 4,235 | 339 |
| Total exposures | 3.21 | 72,147 | 31 | 47 | 33,556 | 2,685 |

1. Other retail includes credit cards, current accounts and personal overdrafts.
2. SME refers to Small to Medium enterprises.

## Note 17 Capital Adequacy *continued*

### Credit risk subject to the Internal Ratings Based ("IRB") approach *continued*

The following table analyses the value and exposure at default of on-balance sheet exposures, off-balance sheet exposures and market-related contracts under the IRB approach by asset class:

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Total Exposure Unaudited 31/3/11 | Exposure at Default Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Capital Requirement Unaudited 31/3/11 |
| **On-balance sheet exposures** | | | | |
| Corporate | 23,142 | 23,142 | 16,861 | 1,349 |
| Sovereign | 3,479 | 3,479 | 46 | 4 |
| Bank | 1,577 | 1,577 | 151 | 12 |
| Residential mortgage | 26,737 | 26,737 | 8,631 | 690 |
| Other retail | 1,539 | 1,539 | 1,303 | 104 |
| Retail SME | 1,802 | 1,802 | 779 | 62 |
| Total on-balance sheet exposures | 58,276 | 58,276 | 27,771 | 2,221 |
| **Off-balance sheet exposures** | | | | |
| Corporate | 7,477 | 6,744 | 3,602 | 288 |
| Sovereign | 70 | 53 | 14 | 1 |
| Bank | 677 | 671 | 117 | 9 |
| Residential mortgage | 2,133 | 2,703 | 620 | 50 |
| Other retail | 3,154 | 1,112 | 418 | 34 |
| Retail SME | 390 | 357 | 135 | 11 |
| Total off-balance sheet exposures | 13,901 | 11,640 | 4,906 | 393 |
| **Market-related contracts** | | | | |
| Corporate | 85,691 | 1,288 | 748 | 60 |
| Sovereign | 11,572 | 388 | 24 | 2 |
| Bank | 202,915 | 555 | 107 | 9 |
| Total market-related contracts | 300,178 | 2,231 | 879 | 71 |
| **Summary** | | | | |
| Corporate | 116,310 | 31,174 | 21,211 | 1,697 |
| Sovereign | 15,121 | 3,920 | 84 | 7 |
| Bank | 205,169 | 2,803 | 375 | 30 |
| Residential mortgage | 28,870 | 29,440 | 9,251 | 740 |
| Other retail | 4,693 | 2,651 | 1,721 | 138 |
| Retail SME | 2,192 | 2,159 | 914 | 73 |
| Total credit risk exposures subject to the internal ratings based approach | 372,355 | 72,147 | 33,556 | 2,685 |

### Equity exposures

The table below shows the capital required to be held as a result of equities held.

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Exposure at Default Unaudited 31/3/11 | Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Exposures Unaudited 31/3/11 | Minimum Pillar One Capital Requirement Unaudited 31/3/11 |
| Equity holdings (not deducted from capital) that are publicly traded | 28 | 300 | 87 | 7 |
| All other equity holdings (not deducted from capital) | 13 | 400 | 50 | 4 |
| Total equity exposures | 41 | 334 | 137 | 11 |

## Note 17 Capital Adequacy *continued*

### Specialised lending subject to the slotting approach

The tables below show specialised lending exposures for which the supervisory slotting approach has been used and includes Project Finance, Object Finance, Commodity Finance and Income Producing Real Estate exposures.

**On-balance sheet exposures subject to the slotting approach**

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Total Exposure at Default after Credit Risk Mitigation Unaudited 31/3/11 | Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Pillar One Capital Requirement Unaudited 31/3/11 |
| Strong | 1,549 | 70 | 1,149 | 92 |
| Good | 927 | 90 | 885 | 71 |
| Satisfactory | 537 | 115 | 655 | 52 |
| Weak | 47 | 250 | 124 | 10 |
| Default[1] | 133 | 0 | - | - |
| Total on-balance sheet exposures subject to the slotting approach | 3,193 | 83 | 2,813 | 225 |

1. Default category represents arrangements that do not have external credit ratings.

The categories of specialised lending above are associated with the risk weight shown. These categories broadly correspond to external credit assessments from Standards & Poor's rating scale: BBB- or better (Strong); BB+ or BB (Good); BB- or B+ (Satisfactory); B to C- (Weak); N/A (Default).

The calculated risk-weighted assets reflected above include the required scalar of 1.06, specified in the Banking Group's conditions of registration, which is not reflected in the risk weight shown.

**Off-balance sheet exposures subject to the slotting approach**

| | Consolidated | | | | |
|---|---|---|---|---|---|
| Dollars in Millions | Total Exposure Unaudited 31/3/11 | Exposure At Default Unaudited 31/3/11 | Average Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Pillar One Capital Requirement Unaudited 31/3/11 |
| Off-balance sheet exposures | 135 | 8 | 81 | 7 | 1 |
| Undrawn commitments | 254 | 276 | 94 | 259 | 21 |
| Market-related contracts | 880 | 55 | 84 | 46 | 4 |
| Total off-balance sheet exposures subject to the slotting approach | 1,269 | 339 | 92 | 312 | 26 |
| Total exposures subject to the slotting approach | | 3,532 | 84 | 3,125 | 251 |

### Credit risk exposures subject to the standardised approach

The tables below and on page 23 show credit risk exposures, for which the standardised approach has been used.

**On-balance sheet exposures subject to the standardised approach**

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | Total Exposure at Default after Credit Risk Mitigation Unaudited 31/3/11 | Average Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Pillar One Capital Requirement Unaudited 31/3/11 |
| Corporate | 37 | 92 | 34 | 3 |
| Residential mortgages | 19 | 39 | 8 | 1 |
| Past due assets | 3 | 94 | 3 | - |
| Other assets | 1,366 | 80 | 1,094 | 88 |
| Total on-balance sheet exposures subject to the standardised approach | 1,425 | 80 | 1,139 | 92 |

Past due assets relate to arrangements that are 90 days past due or considered to be unlikely to be repaid without realising the security. Past due assets include arrangements relating to residential mortgages.

Other assets relate to all other non-lending assets (including interest receivables, account receivables, intangibles and cash accounts) not included in the other categories.

## Note 17 Capital Adequacy *continued*

### Credit risk exposures subject to the standardised approach *continued*

**Off-balance sheet exposures subject to the standardised approach**

| Dollars in Millions | Consolidated Total Exposure or Principal Amount Unaudited 31/3/11 | Average Credit Conversion Factor (%) Unaudited 31/3/11 | Credit Equivalent Amount Unaudited 31/3/11 | Average Risk Weight (%) Unaudited 31/3/11 | Risk-Weighted Assets Unaudited 31/3/11 | Minimum Pillar One Capital Requirement Unaudited 31/3/11 |
|---|---|---|---|---|---|---|
| Total off-balance sheet exposures subject to the standardised approach | 14 | 29 | 4 | 97 | 4 | - |
| **Market-related contracts subject to the standardised approach** | | | | | | |
| Foreign exchange contracts | 78 | N/A | 2 | 100 | 2 | - |
| Interest rate contracts | 3 | N/A | - | 100 | - | - |
| Total market-related contracts subject to the standardised approach | 81 | N/A | 2 | 100 | 2 | - |
| Total exposures subject to the standardised approach | | N/A | 1,431 | 80 | 1,145 | 92 |

### Credit risk mitigation

The Banking Group assesses the integrity and ability of counterparties to meet their contractual financial obligations for repayment. Collateral security in the form of property or a security interest in personal property is generally taken for business credit except for major government, bank and corporate counterparties of strong financial standing. Longer-term consumer finance (e.g. housing loans) is generally secured against real estate while short-term revolving consumer credit is generally unsecured.

The table below shows the total value of exposures covered by eligible financial collateral (after haircutting) for portfolios subject to the standardised approach and total value of exposures covered by credit derivatives and guarantees for all portfolios.

Credit derivatives are held by National Australia Bank Limited on behalf of the Banking Group. No credit derivatives are held directly by the Banking Group. Guarantees are provided by National Australia Bank Limited to the Banking Group.

| Dollars in Millions | Consolidated Corporate (Including Specialised Lending) Unaudited 31/3/11 |
|---|---|
| **For portfolios subject to the standardised approach:** | |
| Total value of exposures covered by eligible financial or IRB collateral (after haircutting) | - |
| **For all portfolios:** | |
| Total value of exposures covered by credit derivatives or guarantees | 30 |

### Residential mortgages by loan-to-valuation ratio

The table below sets out residential mortgages (including loans to businesses) wholly or partly secured by mortgages over residential properties as used to calculate the Banking Group's Pillar One capital requirement by the loan-to-valuation ratio ("LVR").

The LVRs are calculated as the greater of the customer's current loan limit or balance, divided by the Banking Group's valuation of the security at the last credit event for the customer. Where no LVR is available, the exposure is included in the over 90% category.

| Dollars in Millions | Consolidated On-balance Sheet Exposures at Default Unaudited 31/3/11 | Off-balance Sheet Exposures at Default* Unaudited 31/3/11 | Total Exposures at Default Unaudited 31/3/11 |
|---|---|---|---|
| **LVR Range** | | | |
| 0-59% | 9,731 | 1,261 | 10,992 |
| 60-69% | 4,818 | 420 | 5,238 |
| 70-79% | 8,666 | 665 | 9,331 |
| 80-89% | 1,563 | 52 | 1,615 |
| Over 90% | 1,959 | 305 | 2,264 |
| Total exposures at default secured by residential mortgages | 26,737 | 2,703 | 29,440 |

* Off-balance sheet items include unutilised limits and loans approved but not yet drawn.

## Note 17 Capital Adequacy *continued*

### Reconciliation of mortgage-related amounts

| | Consolidated | | | |
|---|---|---|---|---|
| Dollars in Millions | On-balance Sheet Exposures Unaudited 31/3/11 | On-balance Sheet Exposures at Default Unaudited 31/3/11 | Off-balance Sheet Exposures at Default Unaudited 31/3/11 | Total Exposures at Default Unaudited 31/3/11 |
| Total exposures at default secured by residential mortgages based on LVR table | N/A | 26,737 | 2,703 | 29,440 |
| Credit risk exposures secured by residential mortgages subject to the IRB approach | 26,737 | 26,737 | 2,703 | 29,440 |
| Credit risk exposures secured by residential mortgages subject to the standardised approach | 22 | 22 | - | 22 |
| Total exposures secured by residential mortgages | 26,759 | 26,759 | 2,703 | 29,462 |
| **Reconciliation of on-balance sheet mortgage-related exposures from note 17 Capital adequacy to housing loans from note 7 Loans and advances to customers** | | | | |
| Loans and advances to customers – housing loans | 26,743 | | | |
| Add: Partial write offs excluded under the IRB approach | 16 | | | |
| Total exposures secured by residential mortgages | 26,759 | | | |

### Operational risk

| | Consolidated | |
|---|---|---|
| Dollars in Millions | Implied Risk-Weighted Exposure Unaudited 31/3/11 | Total Operational Risk Capital Requirement Unaudited 31/3/11 |
| Operational risk | 3,995 | 320 |

The operational risk capital requirement above has been calculated under the Advanced Measurement Approach which the Banking Group uses for determining its regulatory capital for operational risk. The Advanced Measurement Approach is in accordance with BS2B.

### Market risk

The table below shows market risk end of period and peak end-of-day capital charges.

| | Consolidated | | | |
|---|---|---|---|---|
| | 31/3/11 Unaudited | | | |
| | 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 | 2,269 | 2,931 | 182 | 235 |
| Foreign currency risk | 54 | 123 | 4 | 10 |
| Equity risk | 41 | 44 | 3 | 3 |
| Total | 2,364 | 3,098 | 189 | 248 |

The aggregate market risk exposure above is derived in accordance with BS2B and the Banking Group's conditions of registration.

For each category of market risk, the Banking Group's end of period aggregate capital charge is the charge as at the end of period reported. The peak end-of-day aggregate capital charge is the maximum over the half year accounting period at the close of each business day.

Equity risk subject to a market risk capital charge as shown above relates to equities owned by the Bank.

### Pillar two capital for other material risks

The Banking Group actively manages and measures all material risks affecting its operations. These risks go beyond the traditional banking risks of credit, operational and market risk. The measurement and management of all material risks is determined under the Banking Group's ICAAP and includes consideration of all other material risks, additional to those included in determining the minimum regulatory capital requirements under Basel II Pillar One. Other material risks assessed by the Banking Group include liquidity and funding risk, insurance, concentration, business and financial reporting risk, pension, contagion and regulatory reporting risks.

As at 31 March 2011, the Banking Group had an internal capital allocation for Business Risk of $159 million (31 March 2010: $157 million; 30 September 2010: $150 million). The assessment of Business Risk covers strategic, reputation and earnings risk.

## Note 17 Capital Adequacy *continued*

### National Australia Bank Limited capital adequacy

| | Ultimate Parent Banking Group | | | Ultimate Parent Bank | | |
|---|---|---|---|---|---|---|
| | **Basel II 31/3/11** | Basel II 31/3/10 | Basel II 30/9/10 | **Basel II 31/3/11** | Basel II 31/3/10 | Basel II 30/9/10 |
| Tier One capital expressed as a percentage of total risk-weighted exposures | **9.19%** | 9.09% | 8.91% | **11.00%** | 10.71% | 10.75% |
| Total qualifying capital expressed as a percentage of total risk-weighted exposures | **11.33%** | 12.07% | 11.36% | **13.08%** | 13.58% | 13.11% |

The Ultimate Parent Banking Group data is the Level 2 capital ratio as published in the National Australia Bank Limited Risk and Capital Report ("RCR") and represents the consolidation of the National Australia Banking Group and all its subsidiary entities, other than the non-consolidated subsidiaries as outlined in the RCR. The Level 2 Group operates in multiple regulatory jurisdictions and applies a combination of Basel II advanced and standardised approaches depending on the prescribed prudential requirements within those jurisdictions. Further information on the Basel II methodologies applied across the Ultimate Parent Banking Group is outlined in the RCR.

The ultimate parent bank of the Banking Group is National Australia Bank Limited which reports under the Advanced approach for credit risk (other than for defined assets that are immaterial in terms of RWA or are not required to be treated as IRB under the Basel II framework), and the Advanced Measurement Approach ("AMA") for operational risk. National Australia Bank Limited has also been accredited for interest rate risk in the banking book for its banking operations. The internal model for calculating traded market risk was re-accredited by Australian Prudential Regulation Authority ("APRA") in 2006. The Ultimate Parent Bank capital ratios represent the Level 1 National Australia Bank capital ratios, which comprises National Australia Bank Limited and its subsidiary entities approved by APRA as part of the Extended Licensed Entity.

Under prudential regulations, National Australia Bank Group is required to hold a prudential capital ratio ("PCR") as determined by APRA for both the Level 1 and Level 2 Groups. The PCR is prescribed on a bilateral basis, and is not publicly disclosed. Under APRA's prudential standards, the minimum PCR for Australian Banks is 8% of its total risk-weighted assets, of which a minimum of 4% must be held as Tier One capital. APRA may specify a higher PCR, proportional to the overall risk profile of an Authorised Deposit-taking Institution.

National Australia Bank Limited met the minimum capital adequacy requirements set by APRA as at 31 March 2011.

National Australia Bank Limited is required to publicly disclose Basel II Pillar Three risk management and capital adequacy information at the reporting date, as specified in APRA's Prudential Standard APS 330 Capital Adequacy: Public Disclosure of Prudential Information (APS 330). Updates are provided on a semi-annual and quarterly basis in accordance with the APS 330 reporting requirements. National Australia Bank Limited's Annual Financial Report and RCR, incorporating the requirements of APS 330, can be accessed at www.nabgroup.com.

### Capital structure

**Contributed equity – Ordinary shares**

These shares do not have a par value; each share entitles the shareholder to one vote at any meeting of shareholders. All shares rank equally in dividends and proceeds available to ordinary shareholders in a winding up.

**Contributed equity – Perpetual non-cumulative preference shares**

Each of the perpetual non-cumulative preference shares is non-redeemable and carries no voting rights other than in relation to amendments of the rights, privileges, limitations and conditions attaching to these shares.

**December 2009 issue**

On 29 December 2009, the Bank issued perpetual non-cumulative preference shares ("2009A BNZ PPS") to National Australia Group (NZ) Limited ("NAGNZ"), the Bank's immediate parent and a subsidiary of the Bank's ultimate parent, National Australia Bank Limited ("NAB").

The 2009A BNZ PPS were issued in conjunction with the making of a loan by NAB, acting through its New York branch ("NAB NY"), to NAGNZ. NAGNZ invested the proceeds of the loan in the 2009A BNZ PPS.

The 2009A BNZ PPS are non-redeemable and carry no voting rights other than in relation to amendments of the rights, privileges, limitations and conditions attaching to the 2009A BNZ PPS. Dividends are payable quarterly in arrears, but are non-cumulative if dividends are not paid for the reasons set out below.

The dividend payable on the 2009A BNZ PPS is determined by reference to the seven-year mid-market swap rate plus a margin of 3.50% p.a.. The initial rate was set at 9.25% p.a. on 23 December 2009, applicable for the period from (and including) 29 December 2009 to (but excluding) 28 December 2016. Dividend rates are to be reset seven-yearly on the business day falling two business days before 28 December (or the applicable business day if 28 December is not a business day) in the relevant year. The first dividend reset date is 22 December 2016.

Dividends will not be paid on the 2009A BNZ PPS if any of the following conditions apply: (a) the Directors of the Bank in their sole discretion do not resolve to pay the dividend on the relevant dividend payment date; (b) such a payment would result in the Bank's Tier One capital ratio ceasing to comply with the RBNZ's then current capital adequacy requirements; or (c) the Directors of the Bank are not satisfied that the Bank will be solvent (under the solvency test set out in section 4 of the Companies Act 1993) immediately after payment of the dividend.

If the Bank does not pay a dividend on the 2009A BNZ PPS on a scheduled dividend payment date (for whatever reason), then the Bank must not make any other distribution or payment on or with respect to its other shares that rank equally with or junior to the 2009A BNZ PPS (other than pro-rata distributions or payments on shares that rank equally with the 2009A BNZ PPS) unless and until it has paid two consecutive dividends in full on the 2009A BNZ PPS.

## Note 17 Capital Adequacy *continued*

### Capital structure continued *continued*

Dividends on the 2009A BNZ PPS rank for payment:

- before the Bank's ordinary shareholder;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2009A BNZ PPS; and
- after all other shareholders (including the holders of the 2008 BNZ PPS (refer to March 2008 issue) and 2009 BNZ PPS (refer to June 2009 issue)) and creditors of the Bank.

In the event of liquidation of the Bank, the 2009A BNZ PPS rank:

- before the Bank's ordinary shareholder;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2009A BNZ PPS; and
- after all other shareholders (including the holders of the 2008 BNZ PPS and 2009 BNZ PPS) and creditors of the Bank.

**June 2009 issue**

On 26 June 2009, the Bank issued perpetual non-cumulative preference shares ("2009 BNZ PPS") to BNZ Income Management Limited ("BNZIM"), a subsidiary of the Bank's immediate parent, NAGNZ.

The 2009 BNZ PPS were issued in conjunction with the issue of perpetual non-cumulative shares by BNZ Income Securities 2 Limited ("BNZIS 2"), a subsidiary of the Bank's ultimate parent. Under the transaction, BNZIS 2 issued perpetual non-cumulative shares ("BNZIS 2 Shares") to members of the public in New Zealand. These shares are listed on the NZDX. The proceeds from the issue of BNZIS 2 Shares were advanced to BNZIM as a perpetual loan. BNZIM in turn invested the proceeds of the loan from BNZIS 2 in the 2009 BNZ PPS.

The 2009 BNZ PPS are non-redeemable and carry no voting rights other than in relation to amendments of the rights, privileges, limitations and conditions attaching to the 2009 BNZ PPS. Dividends are payable quarterly in arrears, but are non-cumulative if dividends are not paid for the reasons set out below.

The dividend payable on the 2009 BNZ PPS is determined by reference to the five-year mid-market swap rate plus a margin of 4.09% p.a.. The initial rate was set at 9.10% p.a. on 26 May 2009, applicable for the period from (and including) 26 June 2009 to (but excluding) 30 June 2014 (as 28 June 2014 is not a business day). Dividend rates are to be reset five-yearly on the business day falling two business days before 28 June (or the applicable business day if 28 June is not a business day) in the relevant year. The first dividend reset date is 26 June 2014.

Dividends will not be paid on the 2009 BNZ PPS if any of the following conditions apply: (a) the Directors of the Bank in their sole discretion do not resolve to pay the dividend on the relevant dividend payment date; (b) such a payment would result in any of the Bank's capital ratios ceasing to comply with the RBNZ's then current capital adequacy requirements; (c) the Directors of the Bank are not satisfied that the Bank will be solvent (under the solvency test set out in section 4 of the Companies Act 1993) immediately after payment of the dividend; or (d) (unless APRA otherwise agrees) certain dividend payment conditions apply relating to non-payment of the dividend on the BNZIS 2 Shares payable on the corresponding dividend payment date for the 2009 BNZ PPS (such conditions relating to whether the National Australia Bank Group will still comply with certain APRA capital ratios and have sufficient distributable profits after payment of the relevant dividend on the BNZIS 2 Shares, and to APRA otherwise objecting to the payment of the relevant dividend on the BNZIS 2 Shares).

If the Bank does not pay a dividend on the 2009 BNZ PPS on a scheduled dividend payment date (for whatever reason), then the Bank must not make any other distribution or payment on or with respect to its other shares that rank equally with or junior to the 2009 BNZ PPS (other than pro-rata distributions or payments on shares that rank equally with the 2009 BNZ PPS) unless and until it has paid two consecutive dividends in full on the 2009 BNZ PPS or a call option that applies to the BNZIS 2 Shares has been exercised and the BNZIS 2 Shares have been transferred pursuant to such call option.

Dividends on the 2009 BNZ PPS rank for payment:

- before the Bank's ordinary shareholder and holders of 2009A BNZ PPS;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2009 BNZ PPS; and
- after all other shareholders and creditors of the Bank.

In the event of the liquidation of the Bank, the 2009 BNZ PPS rank:

- before the Bank's ordinary shareholder and holders of 2009A BNZ PPS;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2009 BNZ PPS; and
- after all other shareholders and creditors of the Bank.

**March 2008 issue**

On 28 March 2008, the Bank issued perpetual non-cumulative preference shares ("2008 BNZ PPS") to BNZIM.

The 2008 BNZ PPS were issued in conjunction with the issue of perpetual non-cumulative shares by BNZ Income Securities Limited ("BNZIS"), a subsidiary of the Bank's ultimate parent. Under the transaction, BNZIS issued perpetual non-cumulative shares ("BNZIS Shares") to members of the public in New Zealand. These shares are listed on the NZDX. The proceeds from the issue of the BNZIS Shares were advanced to BNZIM as a perpetual loan. BNZIM in turn invested the proceeds of the loan from BNZIS in the 2008 BNZ PPS.

## Note 17 Capital Adequacy *continued*

### Capital structure continued *continued*

The 2008 BNZ PPS are non-redeemable and carry no voting rights other than in relation to amendments of the rights, privileges, limitations and conditions attaching to the 2008 BNZ PPS. Dividends are payable quarterly in arrears, but are non-cumulative if dividends are not paid for the reasons set out below.

The dividend payable on the 2008 BNZ PPS is determined by reference to the five-year mid-market swap rate plus a margin of 2.20%. The initial rate was set at 9.89% p.a. on 26 March 2008, applicable for the period from (and including) 28 March 2008 to (but excluding) 28 March 2013. Dividend rates are to be reset five-yearly on the business day falling two business days before 28 March (or the applicable business day if 28 March is not a business day) in the relevant year. The first dividend reset date is 26 March 2013.

Dividends will not be paid on the 2008 BNZ PPS if any of the following conditions apply: (a) the Directors of the Bank in their sole discretion do not resolve to pay the dividend on the relevant dividend payment date; (b) such a payment would result in any of the Bank's capital ratios ceasing to comply with the RBNZ's then current capital adequacy requirements; (c) the Directors of the Bank are not satisfied that the Bank will be solvent (under the solvency test set out in section 4 of the Companies Act 1993) immediately after payment of the dividend; or (d) (unless APRA otherwise agrees) certain dividend payment conditions apply relating to non-payment of the dividend on the BNZIS Shares payable on the corresponding dividend payment date for the 2008 BNZ PPS (such conditions relating to whether the National Australia Bank Group will still comply with certain APRA capital ratios and have sufficient distributable profits after payment of the relevant dividend on the BNZIS Shares, and to APRA otherwise objecting to the payment of the relevant dividend on the BNZIS Shares).

If the Bank does not pay a dividend on the 2008 BNZ PPS on a scheduled dividend payment date (for whatever reason), then the Bank must not make any other distribution or payment on or with respect to its other shares that rank equally with or junior to the 2008 BNZ PPS (other than pro-rata distributions or payments on shares that rank equally with the 2008 BNZ PPS) unless and until it has paid two consecutive dividends in full on the 2008 BNZ PPS or a call option that applies to the BNZIS Shares has been exercised and the BNZIS Shares have been transferred pursuant to such call option.

Dividends on the 2008 BNZ PPS rank for payment:

- before the Bank's ordinary shareholder and holders of 2009A BNZ PPS;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2008 BNZ PPS; and
- after all other shareholders and creditors of the Bank.

In the event of the liquidation of the Bank, the 2008 BNZ PPS rank:

- before the Bank's ordinary shareholder and holders of 2009A BNZ PPS;
- equally with any other shares issued by the Bank that, by their terms, are expressed to rank equally with the 2008 BNZ PPS; and
- after all other shareholders and creditors of the Bank.

**Subordinated debt**

Subordinated debt ranks behind the claims of all other creditors in a winding up. Material terms and conditions relating to the subordinated debt are as follows:

**Subordinated loans from related entities held in upper Tier Two capital**

These loans have no fixed maturity and are repayable only at the Bank's option, subject to certain conditions, at any time on seven days' notice. The interest rate is reset every three months based on a margin over the prevailing rate for New Zealand 90-day bank bills.

**Subordinated loans from related entities held in lower Tier Two capital**

These loans have no fixed maturity and are repayable on five years and one day's notice. The interest rate is reset every three months based on a margin over the prevailing rate for New Zealand 90-day bank bills.

**Other subordinated debt held in lower Tier Two capital**

The coupon rate on these bonds is 8.42% p.a., payable semi-annually in arrears. The bonds have a maturity date of 15 June 2017, but can be called by the Bank on 15 June 2012. If the bonds are not called by the Bank on 15 June 2012 they will continue to pay interest at the five year swap rate plus 0.75%.

## Note 18 Financial Risk Management

### Financial risk management policies

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 September 2010.

### Interest rate repricing schedule

The following table represents a breakdown, by repricing dates or contractual maturity, whichever is the earlier, of the balance sheet. As interest rates and yield curves change over time, the Banking Group may be exposed to a loss in earnings due to the characteristics of the assets and their corresponding liability funding. These mismatches are actively managed as part of the overall interest rate risk management process. In managing the structural interest rate risk, the primary objectives are to limit the extent to which net interest income could be impacted from an adverse movement in interest rates and to maximise shareholders' earnings.

| | Consolidated (31/3/11 Unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| Dollars in Millions | Total | Up to 3 Months | Over 3 Months and up to 6 Months | Over 6 Months and up to 1 Year | Over 1 Year and up to 2 Years | Over 2 Years | Non-Interest Sensitive |
| **Assets** | | | | | | | |
| Cash and balances with central banks | 1,566 | 1,423 | - | - | - | - | 143 |
| Due from other financial institutions | 1,035 | 1,001 | - | - | - | - | 34 |
| Trading securities | 3,431 | 3,431 | - | - | - | - | - |
| Other money market placements | 333 | 333 | - | - | - | - | - |
| Available for sale investments | 188 | 66 | 63 | 30 | - | - | 29 |
| Gross loans and advances to customers | 56,172 | 34,526 | 2,462 | 4,006 | 6,908 | 7,474 | 796 |
| Deductions from loans and advances to customers | (453) | - | - | - | - | (2) | (451) |
| Derivative financial instruments | 4,588 | - | - | - | - | - | 4,588 |
| Amounts due from related entities | 721 | 702 | - | - | - | - | 19 |
| All other assets | 1,087 | - | - | - | - | - | 1,087 |
| Total assets | 68,668 | 41,482 | 2,525 | 4,036 | 6,908 | 7,472 | 6,245 |
| **Liabilities** | | | | | | | |
| Due to central banks and other financial institutions | 875 | 837 | 6 | 26 | - | - | 6 |
| Other money market deposits | 10,104 | 5,946 | 2,336 | 1,776 | 27 | 19 | - |
| Deposits from customers | 30,608 | 19,790 | 6,508 | 2,034 | 838 | 533 | 905 |
| Derivative financial instruments | 5,187 | - | - | - | - | - | 5,187 |
| Bonds and notes | 11,226 | 2,668 | 504 | - | 1,367 | 6,687 | - |
| Amounts due to related entities | 4,484 | 4,377 | 22 | - | - | - | 85 |
| Subordinated debt | 1,278 | 905 | - | - | 373 | - | - |
| All other liabilities | 836 | - | - | - | - | - | 836 |
| Total liabilities | 64,598 | 34,523 | 9,376 | 3,836 | 2,605 | 7,239 | 7,019 |
| Net balance of derivative financial instruments | | (3,729) | 4,481 | (142) | (1,301) | 691 | |

## Note 18 Financial Risk Management *continued*

### Maturity profile

The table below presents the Banking Group's cash flows by remaining contractual maturities as at the reporting date, except Available for sale investments, Trading securities and Trading liabilities, which the Banking Group has the ability to realise at short notice.

The gross cash flows disclosed below are the contractual undiscounted cash flows and therefore will not agree to the carrying values on the balance sheet. Actual cash flows can differ significantly from contractual cash flows as a result of future actions of the Banking Group and its counterparties, such as early repayments or refinancing of term loans. Off-balance sheet exposures are excluded from the table below as contractual cash flows, if any, are contingent in nature. Irrevocable commitments to extend credit can be drawn down at anytime before the commitments expire. Details of off-balance sheet exposures are included in note 14. Other assets and other liabilities only include balances which have contractual future cash flows.

| | Consolidated (31/3/11 Unaudited) | | | | | | |
|---|---|---|---|---|---|---|---|
| Dollars in Millions | Carrying Amount | Gross Cash Inflow/ (Outflow) | On Demand | 3 Months or less | 3 to 12 Months | 1 to 5 Years | Over 5 Years |
| **Assets** | | | | | | | |
| Cash and balances with central banks | 1,566 | 1,566 | 1,369 | 197 | - | - | - |
| Due from other financial institutions | 1,035 | 1,036 | 80 | 956 | - | - | - |
| Trading securities | 3,431 | 3,431 | - | 3,431 | - | - | - |
| Other money market placements | 333 | 334 | 228 | 106 | - | - | - |
| Available for sale investments | 188 | 188 | - | 66 | 122 | - | - |
| Loans and advances to customers | 55,719 | 76,483 | 3,495 | 15,994 | 7,370 | 16,873 | 32,751 |
| Amounts due from related entities | 721 | 722 | 672 | 33 | 17 | - | - |
| Other assets | 250 | 250 | - | 250 | - | - | - |
| Total | 63,243 | 84,010 | 5,844 | 21,033 | 7,509 | 16,873 | 32,751 |
| **Liabilities** | | | | | | | |
| Due to central banks and other financial institutions | (875) | (876) | (404) | (439) | (33) | - | - |
| Other money market deposits | (10,104) | (10,139) | (339) | (6,129) | (3,621) | (50) | - |
| Deposits from customers | (30,608) | (31,040) | (12,101) | (8,665) | (8,710) | (1,564) | - |
| Bonds and notes | (11,226) | (12,842) | - | (434) | (1,461) | (6,706) | (4,241) |
| Amounts due to related entities | (4,484) | (4,783) | (89) | (1,663) | (193) | (2,838) | - |
| Subordinated debt | (1,278) | (1,622) | - | (32) | (31) | (245) | (1,314) |
| Other liabilities | (697) | (697) | - | (651) | (46) | - | - |
| Total | (59,272) | (61,999) | (12,933) | (18,013) | (14,095) | (11,403) | (5,555) |
| **Derivatives** | | | | | | | |
| Derivative financial instruments inflow | | 59,545 | - | 31,233 | 12,082 | 10,480 | 5,750 |
| Derivative financial instruments (outflow) | | (61,166) | - | (31,386) | (12,472) | (11,506) | (5,802) |

### Liquidity portfolio management

The table below shows financial assets held by the Banking Group for the purpose of managing liquidity risk.

| | Consolidated |
|---|---|
| Dollars in Millions | Unaudited 31/3/11 |
| Cash and balances immediately convertible to cash | 2,097 |
| Securities purchased under agreements to resell | 261 |
| Treasury bills | 1,380 |
| Government securities | 1,164 |
| Semi-government securities | 85 |
| Bank bills | 70 |
| Bank bonds | 344 |
| Other securities | 73 |
| Total liquidity portfolio | 5,474 |

As at 31 March 2011, the Banking Group also held unencumbered residential mortgage-backed securities ("RMBS") of $4,491 million. The RMBS assets can be purchased under agreements to resell for liquidity purposes. The RBNZ has imposed a cap limiting the amount of RMBS deemed as eligible in the liquidity portfolio to 4% of total assets.

## Note 18 Financial Risk Management *continued*

### Concentrations of funding

The Banking Group's concentrations of funding is reported by geographical location and industry sector in the table below. The concentrations of funding by geographical location is based on the geographical location of the office in which the funds are recognised. The concentrations of funding by industry sector is based on the categories in the RBNZ M3 Institutions Standard Statistical Return.

| | Consolidated |
|---|---|
| Dollars in Millions | Unaudited 31/3/11 |
| **New Zealand** | |
| Agriculture, forestry and fishing | 1,685 |
| Mining | 184 |
| Manufacturing | 1,322 |
| Electricity, gas and water | 66 |
| Construction | 360 |
| Wholesale and retail trade | 1,068 |
| Accommodation, restaurants, culture and recreation | 713 |
| Transport and storage | 624 |
| Communications | 146 |
| Financial, investment and insurance | 11,804 |
| Property, business and personal services | 4,920 |
| Government, education, health and community services | 2,103 |
| Personal deposits | 15,545 |
| Related entities | 5,090 |
| Total New Zealand | 45,630 |
| **United Kingdom** | |
| Financial, investment and insurance | 12,169 |
| Total United Kingdom | 12,169 |
| **Singapore** | |
| Financial, investment and insurance | 133 |
| Personal deposits | 318 |
| Property, business and personal services | 26 |
| Related entities | 299 |
| Total Singapore | 776 |
| Total funding | 58,575 |
| **Total funding comprised:** | |
| Due to central banks and other financial institutions | 875 |
| Other money market deposits | 10,104 |
| Deposits from customers | 30,608 |
| Bonds and notes | 11,226 |
| Amounts due to related entities | 4,484 |
| Subordinated debt* | 1,278 |
| Total funding | 58,575 |

* Included in Subordinated debt was $905 million due to related entities as at 31 March 2011.

## Note 18 Financial Risk Management *continued*

### Concentrations of credit exposure

The Banking Group's concentrations of credit exposure is reported by geographical location and industry sector in the table below. The concentrations of credit exposure on financial assets by geographical location is based on the geographical location of the counterparty's tax residency. The concentrations of credit exposure relating to guarantees and credit related commitments by geographical location is based on geographical location of the office in which the exposures are recognised. The concentrations of credit exposure by industry sector is based on the categories in the RBNZ M3 Institutions Standard Statistical Return.

The table below presents the maximum exposure to credit risk of financial assets before taking into account any collateral held or other credit enhancements, and credit risk exposures relating to guarantees and credit related commitments. Except for derivative financial instruments, the majority of the overseas credit exposures are raised for New Zealand based assets funded in New Zealand dollars for offshore customers. For more information on guarantees and credit related commitments, refer to note 14.

| | Consolidated |
|---|---|
| Dollars in Millions | Unaudited 31/3/11 |
| **Financial assets** | |
| **New Zealand** | |
| Agriculture | 9,243 |
| Forestry and fishing | 575 |
| Mining | 177 |
| Manufacturing | 2,447 |
| Electricity, gas and water | 810 |
| Construction | 607 |
| Wholesale and retail trade | 2,307 |
| Accommodation, restaurants, culture and recreation | 897 |
| Transport and storage | 945 |
| Communications | 183 |
| Financial, investment and insurance | 3,240 |
| Property, business and personal services | 8,271 |
| Government, education, health and community services | 5,586 |
| Real estate – mortgage | 26,315 |
| Personal lending | 1,795 |
| Related entities | 307 |
| Total New Zealand | 63,705 |
| **Overseas** | |
| Agriculture | 3 |
| Forestry and fishing | 2 |
| Manufacturing | 1 |
| Wholesale and retail trade | 11 |
| Accommodation, restaurants, culture and recreation | 3 |
| Transport and storage | 2 |
| Communications | 3 |
| Financial, investment and insurance | 3,094 |
| Property, business and personal services | 4 |
| Government, education, health and community services* | 198 |
| Real estate – mortgage | 428 |
| Personal lending | 27 |
| Related entities | 414 |
| Total Overseas | 4,190 |
| Total credit exposures on financial assets | 67,895 |
| **Total credit exposures on financial assets comprised:** | |
| Balances with central banks | 1,427 |
| Due from other financial institutions | 1,035 |
| Trading securities | 3,431 |
| Other money market placements | 333 |
| Available for sale investments | 188 |
| Gross Loans and advances to customers | 56,172 |
| Derivative financial instruments | 4,588 |
| Amounts due from related entities | 721 |
| Total credit exposures on financial assets | 67,895 |

* Includes balances with Supranationals.

Notes to and Forming Part of the Interim Financial Statements *continued*

## Note 18 Financial Risk Management *continued*

### Concentrations of credit exposure *continued*

| Dollars in Millions | Consolidated Unaudited 31/3/11 |
|---|---|
| **Guarantees and credit related commitments** | |
| **New Zealand** | |
| Agriculture | 522 |
| Forestry and fishing | 68 |
| Mining | 62 |
| Manufacturing | 1,163 |
| Electricity, gas and water | 828 |
| Construction | 136 |
| Wholesale and retail trade | 959 |
| Accommodation, restaurants, culture and recreation | 234 |
| Transport and storage | 228 |
| Communications | 197 |
| Financial, investment and insurance | 623 |
| Property, business and personal services | 654 |
| Government, education, health and community services | 655 |
| Real estate - mortgage | 1,286 |
| Personal lending | 322 |
| Total New Zealand | 7,937 |
| Total credit exposures on guarantees and credit related commitments | 7,937 |

## Auditor's Independent Review Report

To the shareholders of Bank of New Zealand

We have reviewed pages 3 to 32 of the Disclosure Statement for the six months ended 31 March 2011 of Bank of New Zealand (the "Bank") and its subsidiaries (the "Banking Group") which consists of the interim financial statements and the supplementary information required by Schedules 5, 7, 11, 13, 16 and 18 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2011 (the "Order"). The interim financial statements comprise the balance sheet as at 31 March 2011, the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the six months then ended, and a statement of accounting policies and other explanatory information for the Banking Group.

This report is made solely to the Bank's shareholders, as a body. Our review has been undertaken so that we might state to the Bank's shareholders those matters we are required to state to them in an independent auditor's review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's shareholders as a body, for our review work, for this report, or for our findings.

**Directors' responsibilities**

The directors of Bank of New Zealand (the "Directors") are responsible for the Disclosure Statement which includes interim financial statements prepared in accordance with Clause 25 of the Order and that fairly present the financial position of the Banking Group as at 31 March 2011, and its financial performance and cash flows for the six months ended on that date. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for including supplementary information in the Disclosure Statement which complies with Schedules 3, 5, 7, 11, 13, 16 and 18 of the Order.

**Reviewer's responsibilities**

We are responsible for reviewing the interim financial statements and the supplementary information, disclosed in accordance with Clause 25, Schedules 5, 7, 11, 13, 16 and 18 of the Order and presented to us by the Directors.

We are responsible for reviewing the financial statements (excluding the supplementary information) in order to report to you whether, in our opinion 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 New Zealand Equivalent to International Accounting Standard 34: Interim Financial Reporting ("NZ IAS 34") and do not fairly present the financial position of the Banking Group as at 31 March 2011 and its financial performance and cash flows for the six months ended on that date.

We are responsible for reviewing the supplementary information (excluding the supplementary information relating to capital adequacy) in order to report to you whether, in our opinion 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 does not fairly state the matters to which it relates in accordance with Schedules 5, 7, 13, 16 and 18 of the Order.

We are responsible for reviewing the supplementary information relating to capital adequacy in order to report to you whether, in our opinion on the basis of procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information relating to capital adequacy is not in all material respects:

a) prepared in accordance with the Bank's Conditions of Registration;
b) prepared in accordance with the Bank's internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and
c) disclosed in accordance with Schedule 11 of the Order.

# Auditor's Independent Review Report *continued*

Ernst & Young

**Basis of review opinion**

A review is limited primarily to enquiries of the Bank and Banking Group personnel and analytical review procedures applied to financial data, and thus provides less assurance than an audit. We have not performed an audit on the interim financial statements and, accordingly, we do not express an audit opinion.

We have reviewed the interim financial statements, and the supplementary information required by Schedules 5, 7, 11, 13, 16 and 18 of the Order, of the Banking Group for the six months ended 31 March 2011 in accordance with the Review Engagement Standards issued by the New Zealand Institute of Chartered Accountants.

Ernst & Young provides regulatory audit and other assurance related services to the Bank and Banking Group. We have no other relationship with, or interest in, the Bank or Banking Group.

Partners and employees of our firm may deal with the Bank and Banking Group on normal terms within the ordinary course of trading activities of the business of the Bank and Banking Group. These matters have not impaired our independence as auditors of the Bank and Banking Group.

**Statement of review findings**

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

- the interim financial statements on pages 3 to 32 (excluding the supplementary information), which have been prepared in all material respects in accordance with NZ IAS 34, do not fairly present the financial position of the Banking Group as at 31 March 2011 and its financial performance and cash flows for the six month period ended on that date;
- the supplementary information 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 prescribed in Schedule 11 of the Order, is not, in all material respects:
  - prepared in accordance with the Bank's Conditions of Registration;
  - prepared in accordance with the Bank's internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and
  - disclosed in accordance with Schedule 11 of the Order.

Our review was completed on 19 May 2011 and our findings are expressed as at that date.

Ernst + Young

Auckland

## Credit Ratings

Bank of New Zealand has the following credit ratings applicable to its long-term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

| Rating Agency | Current Credit Rating | Qualification |
|---|---|---|
| Standard & Poor's (Australia) Pty Limited | AA | Outlook Stable |
| Moody's Investors Service, Inc | Aa2 | Ratings Under Review |

On 17 February 2011, Moody's Investors Service placed the Bank's credit rating on review for possible downgrade.

## Conditions of Registration

### Changes in conditions of registration

On 31 March 2011 the following changes were made to the Bank's conditions of registration:

- a new condition was added with effect from 1 April 2011 to limit the issuance of covered bonds to not more than 10% of total assets;
- the corporate governance conditions were revised following RBNZ issuing BS14 relating to Corporate Governance. The changes affect the composition of the board and appointment of board members and will take effect from 1 April 2012;
- the liquidity conditions have been updated to reflect the requirements set out in the RBNZ's Liquidity Policy (BS13) and Liquidity Policy Annex: Liquid Assets (BS13A) which take effect from 1 April 2011; and
- conditions relating to the capital adequacy framework were amended by the removal of the capital floor based on 90% of the Basel I capital calculation and the removal of the supervisory adjustment for residential mortgage risk weights.

# Directors' Statement

The Directors of Bank of New Zealand (the "Bank") state that each Director of the Bank believes, after due enquiry, that:

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

    (a) the Disclosure Statement contains all the information that is required by the Order; and

    (b) the Disclosure Statement is not false or misleading; and

2. during the six months ended 31 March 2011:

    (a) the Bank has complied with its conditions of registration applicable during that period;

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

    (c) the Bank 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.

This Disclosure Statement is dated 19th of May 2011 and signed by Messrs. Waller and Thorburn as Directors and as responsible persons on behalf of all the other Directors.

**J A Waller**
Chairman

**A G Thorburn**
Managing Director and Chief Executive Officer