Westpac NZ Covered Bond Limited

Annual report

For the year ended 30 September 2018

Westpac NZ Covered Bond Limited

Contents

This annual report covers Westpac NZ Covered Bond Limited (the '**Company**') as an individual entity.

Westpac NZ Covered Bond Limited is a company limited by shares, incorporated and domiciled in New Zealand. Its registered office is:

Westpac on Takutai Square
16 Takutai Square
Auckland

The members of the Board of Directors of the Company ('**Board**') as at the signing date of these financial statements are Mark Broughton Weenink, James Bennett Reardon and Euan Hamilton Abernethy.

Westpac NZ Covered Bond Limited

Directors' report

Pursuant to section 211(3) of the Companies Act 1993, the shareholder of the Company has agreed that the Annual Report of the Company need not comply with the requirements of paragraphs (a), and (e) to (j) of subsection (1) and subsection (2) of section 211.

Accordingly, there is no information to be included in the Annual Report other than the financial statements for the year ended 30 September 2018 and the independent auditor's report on those financial statements.

For and on behalf of the Board.

Director
4 December 2018

Director
4 December 2018

Westpac NZ Covered Bond Limited

Statement of comprehensive income for the year ended 30 September

	Note	2018 $'000	2017 $'000
Interest income		222,238	234,677
Interest expense		(233,218)	(243,810)
Net interest expense	2	(10,980)	(9,133)
Non-interest income	3	12,851	10,889
Net operating income before operating expenses		1,871	1,756
Operating expenses	4	(1,749)	(1,639)
Profit before income tax		122	117
Income tax expense	6	-	-
Net profit for the year		122	117
Other comprehensive income (net of tax)			-
Total comprehensive income for the year		122	117

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

Balance sheet as at 30 September

	Note	2018 $'000	2017 $'000
Assets			
Cash and cash equivalents	8	1,179,847	1,266,948
Receivables due from related entities	8	6,339,344	6,252,960
Total assets		7,519,191	7,519,908
Liabilities			
Payables due to related entities	8	7,519,050	7,519,789
Total liabilities		7,519,050	7,519,789
Net assets		141	119
Shareholders' equity			
Capital and reserves attributable to equity holders of the parent			
Share capital	7	1	1
Retained profits		140	118
Total shareholders' equity		141	119

The above balance sheet should be read in conjunction with the accompanying notes.

Statement of changes in equity for the year ended 30 September

	Note	Attributable to owners of the Company Share Capital $'000	Retained Profits $'000	Total $'000
As at 1 October 2016		1	100	101
Year ended 30 September 2017				
Net profit for the year		-	117	117
Total comprehensive income for the year ended 30 September 2017		-	117	117
Transaction with the owners:				
Dividends paid on ordinary shares	7	-	(99)	(99)
As at 30 September 2017		1	118	119
Year ended 30 September 2018				
Net profit for the year		-	122	122
Total comprehensive income for the year ended 30 September 2018		-	122	122
Transaction with the owners:				
Dividends paid on ordinary shares	7	-	(100)	(100)
As at 30 September 2018		1	140	141

The above statement of changes in equity should be read in conjunction with the accompanying notes.

pwc

Westpac NZ Covered Bond Limited

Statement of cash flows for the year ended 30 September

	Note	2018 $'000	2017 $'000
Cash flows from operating activities			
Interest income received		222,760	237,041
Guarantee fees received		12,851	10,574
Interest expense paid		(233,957)	(245,321)
Operating expenses paid		(1,749)	(1,620)
Net cash (used in) / provided by operating activities	11	(95)	674
Cash flows from investing activities			
Principal collection from underlying housing loans		1,374,450	1,498,310
Purchase of housing loans to replenish/increase the cover pool		(1,461,356)	(999,917)
Net cash (used in) / provided by investing activities		(86,906)	498,393
Cash flows from financing activities			
Dividends paid on ordinary shares	7	(100)	(99)
Net cash used in financing activities		(100)	(99)
Net (decrease) / increase in cash and cash equivalents		(87,101)	498,968
Cash and cash equivalents at beginning of the year		1,266,948	767,980
Cash and cash equivalents at end of the year	8	1,179,847	1,266,948

The above statement of cash flows should be read in conjunction with the accompanying notes.

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 1. Financial statement preparation

These financial statements were authorised for issue by the Board on 4 December 2018. The Board has the power to amend the financial statements after they are authorised for issue.

The Company is a special purpose entity which was set up to purchase and hold housing loans ('**cover pool**') and to provide financial guarantees of the covered bonds issued from time to time by Westpac Securities NZ Limited ('**WSNZL**') under Westpac New Zealand Limited's ('**WNZL**') Global Covered Bond programme ('**CB Programme**'). The principal accounting policies are set out below and in the relevant notes to the financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Basis of preparation

(i) Basis of accounting

These financial statements are general purpose financial statements prepared in accordance with UK Listing Authority Listing Rules. These financial statements comply with Generally Accepted Accounting Practice, applicable New Zealand equivalents to International Financial Reporting Standards ('**NZ IFRS**') and other authoritative pronouncements of the External Reporting Board ('**XRB**'), as appropriate for for-profit entities. These financial statements comply with International Financial Reporting Standards ('**IFRS**'), as issued by the International Accounting Standards Board.

The Company is Tier 1 entity, however the Company has no public accountability.

All amounts in these financial statements have been rounded in thousands of New Zealand dollars unless otherwise stated.

(ii) Historical cost convention

These financial statements have been prepared under the historical cost convention. The going concern concept has been applied.

(iii) Changes in accounting standards

The Company has adopted the requirements of Disclosure Initiative: Amendments to NZ IAS 7 *Statement of Cash Flows* which require additional disclosures regarding both cash and non-cash changes in liabilities arising from financing activities. As the Company does not have any liabilities arising from financing activities, no additional disclosure is required.

(iv) Foreign currency translations

These financial statements are presented in New Zealand dollars which is the Company's functional and presentation currency.

There are no transactions or balances denominated in foreign currencies.

b. Financial assets and financial liabilities

(i) Recognition

Purchases and sales of financial assets, except for loans and receivables, are recognised on trade-date; the date on which the Company commits to purchase or sell the asset. Loans and receivables are recognised on settlement date when cash is advanced to the borrowers.

Financial liabilities are recognised when an obligation arises.

(ii) Classification and measurement

The Company classifies its financial assets as loans and receivables.

The Company classifies its financial liabilities as financial liabilities at amortised cost.

All other financial assets and financial liabilities are recognised initially at fair value adjusted for directly attributable transaction costs.

The accounting policy for each category of financial asset or financial liability mentioned above is set out in Note 8.

The Company's policies for determining the fair value of financial assets and financial liabilities are set out in Note 10.

(iii) Derecognition

Financial assets are derecognised when the rights to receive cash flows from the asset have expired, or when the Company has either transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full under a 'pass through' arrangement and transferred substantially all the risks and rewards of ownership.

There may be situations where the Company has partially transferred the risks and rewards of ownership but has neither transferred nor retained substantially all the risks and rewards of ownership. In such situations, if the Company has retained control, the asset continues to be recognised on the balance sheet to the extent of the Company's continuing involvement in the asset.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, the exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, with the difference in the respective carrying amounts recognised in profit or loss.

(iv) Impairment of financial assets

The Company assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment charges are recognised if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a '**loss event**') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 1. Financial statement preparation (continued)

If there is objective evidence that an impairment on loans and receivables has been incurred, the amount of the charge is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in profit or loss. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate determined under the contract.

Statement of cash flows

Operating, investing and financing activities

Operating activities are the principal revenue-producing activities of the Company and other activities that are not investing or financing activities. Investing activities are the acquisition and disposal of long-term assets and other investments that are not included in cash and cash equivalents. Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the Company.

c. Critical accounting assumptions and estimates

Applying the Company's accounting policies requires the use of judgment, assumptions and estimates which impact the financial information. The significant assumptions and estimates used are discussed in Note 10.

d. Future developments in accounting standards

The following new standards and interpretations which may have a material impact on the Company have been issued, but are not yet effective and have not been early adopted by the Company:

NZ IFRS 9 *Financial Instruments* ('NZ IFRS 9') will replace NZ IAS 39 *Financial Instruments: Recognition and Measurement* ('NZ IAS 39'). It includes a forward looking 'expected credit loss' impairment model, revised classification and measurement model and modifies the approach to hedge accounting. The standard is effective from 1 October 2018.

NZ IFRS 9 requires financial assets to be classified on the basis of the business model for managing financial assets and the contractual cash flow characteristics of the financial asset, and subsequently measures the financial assets as either at amortised cost or fair value.

NZ IFRS 9 is not expected to have an impact on the classification of the intercompany loan as the contractual cash flows remain consistent with a basic lending arrangement and qualify as solely payments of principal and interest.

The requirements for classifying and measuring financial liabilities remain largely unchanged from NZ IAS 39.

The new expected credit loss model introduced in NZ IFRS 9 (ECL impairment model) is not expected to have a material impact on the Company. The intercompany loan with WNZL is not subject to material credit risk, as WNZL is contractually obligated to repurchase any impaired loans in the cover pool.

As the Company does not apply hedge accounting, the NZ IFRS 9 hedge accounting related changes do not have an impact on the financial statements.

The Company will apply NZ IFRS 9 for the first time in the 30 September 2019 financial year.

NZ IFRS 15 *Revenue from Contracts with Customers* ('NZ IFRS 15') will replace NZ IAS 18 *Revenue* and related interpretations, and applies to all contracts with customers except leases, financial instruments and insurance contracts. The standard is effective from 1 October 2018.

The standard provides a systematic approach to revenue recognition by introducing a five-step model governing revenue measurement and recognition. The core principle of this standard is that an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Company has assessed the impact of NZ IFRS 15 and has concluded that no changes to the current accounting treatment of guarantee fee income is required.

The Company will apply NZ IFRS 15 for the first time in the 30 September 2019 financial year.

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 2. Net interest expense

Accounting policy

Interest income and expense for all interest earning financial assets and interest bearing financial liabilities, detailed within the table below, is recognised using the effective interest rate method.

The effective interest rate method calculates the amortised cost of a financial instrument by discounting the financial instrument's estimated future cash receipts or payments to their present value and allocates the interest income or interest expense, including any fees, costs, premiums or discounts integral to the instrument, over its expected life.

	Note	2018 $'000	2017 $'000
Interest income			
Receivables due from related entities	8	222,238	234,677
Total interest income		222,238	234,677
Interest expense			
Payables due to related entities	8	(233,218)	(243,810)
Total interest expense		(233,218)	(243,810)
Net interest expense		(10,980)	(9,133)

All interest income and interest expense arise from financial assets and financial liabilities not at fair value through profit or loss.

Note 3. Non-interest income

Accounting policy

Fees are recognised on an accrual basis over the period during which the service is performed.

	Note	2018 $'000	2017 $'000
Non-interest income			
Guarantee fee income - related entities	8	12,851	10,889
Total non-interest income		12,851	10,889

Note 4. Operating expenses

	Note	2018 $'000	2017 $'000
Management fees - related entities	8	750	750
Contingent swap fees - related entities	8	771	653
Security trustee fees - related entities	8	94	98
Directors' fees	8	31	31
Auditor's fees - non-audit services in relation to the covered bond programme		101	101
Purchased services		2	6
Total operating expenses		1,749	1,639

Note 5. Auditor's remuneration

The audit fees for the year ended 30 September 2018 for the audit of financial statements amounting to $11,750 (2017: $11,250) were borne by WNZL. Non-audit services in relation to the covered bond programme, amounting to nil (30 September 2017: $14,000) were borne by WNZL.

Note 6. Income tax expense

Accounting policy

Income tax

The Company does not have an income tax expense, current tax or deferred tax balance due to being a financial institution special purpose vehicle. WNZL is deemed to carry on the activity of the Company for tax purposes and therefore accounts for the taxable income of the Company. Accordingly, the Company does not make any income tax payments and has a nil imputation credit balance.

Goods and services tax ('GST')

Where applicable, revenue, expenses and assets are recognised net of GST, except to the extent that GST is not recoverable from Inland Revenue. In these circumstances, the GST is recognised as part of the expense or the cost of the asset.

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 6. Income tax expense (continued)

	2018 $'000	2017 $'000
Income tax expense		
Current tax	-	-
Total income tax expense	-	-
Reconciliation of income tax expense to profit before income tax expense		
Profit before income tax expense	122	117
Tax calculated at a rate of 28% (30 September 2017: 28%)	34	33
Tax effect of amounts which are not assessable in calculating taxable income:		
Income not assessable for tax purposes	(34)	(33)
Total income tax expense	-	-

Note 7. Shareholders' equity

Accounting policy

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

Ordinary shares fully paid

	2018 Number of Authorised and Issued Shares	2017 Number of Authorised and Issued Shares
Balance at beginning of the year	1,000	1,000
Balance at end of the year	1,000	1,000

Ordinary shares

Ordinary shares entitle the holder, subject to the constitution of the Company, to carry the right to one vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the Company in the event of winding up. Under the constitution of the Company, the Board may only authorise a dividend if the dividend is payable on or after a Distribution Date (as defined in the Master Definitions and Construction Agreement entered into on 26 November 2010) and if the aggregate dividend declared does not exceed the lesser of (i) $100,000 and (ii) the net profit after tax of the Company for the period ending on that Distribution Date after providing or paying for all obligations in respect of such period ending on the Distribution Date.

Pursuant to a Deed of Agreement ('**Deed**') dated 23 November 2010, the Company and Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**') agreed to be bound by the terms of the constitution of the Company and WNZCBHL. Further, in the event that there is a change in the shareholder of the Company, then WNZCBHL agreed to ensure that any new shareholder will accede to the Deed. The constitution of the Company provides that if a deadlock (i.e. a resolution put to the Board which was not passed due to an equal number of votes of Directors for and against passing such resolution) occurs, any Director of the Company may give written notice of the deadlock to the board of the shareholder of the Company, and the shareholders will make a decision in relation to the deadlock. The constitution of WNZCBHL provides that there shall be a deadlock panel comprising an authorised person of each shareholder of WNZCBHL.

The effect of the above is that voting does not take place in proportion to the number of ordinary shares held.

The ordinary shares have no par value.

Dividends paid

In the year ended 30 September 2018, the Company paid dividends in respect of the ordinary shares amounting to $100,000 (2017: $99,000).

Note 8. Related entities

Accounting policy

Related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions, or one other party controls both. Examples include subsidiaries, associates, joint ventures and superannuation plans as well as key management personnel and their related parties.

Cash and cash equivalents

Cash and cash equivalents include cash at bank and at call money market deposits. Cash equivalents are short-term and highly liquid used in the day-to-day management of the Company that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Receivables due from related entities

Due from related entities is the financial asset recognised by the Company in the form of a deemed loan to WNZL representing the underlying pool of housing loans. As a consequence of the Company being a guarantor under the CB Programme, it entered into several linked arrangements with WNZL, including interest rate swaps, a servicing fee, and an asset performance fee (net of impairment losses). These arrangements are accounted for as one transaction when the overall economic effect cannot be understood without reference to the series of transactions as a whole. Any accrued interest in respect of the deemed loan is also treated as part of the loan. Due from related entities also includes accrued guarantee fees receivable from WSNZL. Due from related entities is accounted for as loans and receivables and subsequently measured at amortised cost using the effective interest rate method and presented net of any provisions for impairment.

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 8. Related entities (continued)

Payables due to related entities

Due to related entities include demand and guarantee loans which are subsequently measured at amortised cost, accrued interest arising on amounts due to related entities, accrued security trustee fees payable to NZGT (WNZCB) Security Trustee Limited and the accrued contingent swap fee payable to a related entity. These are all measured at amortised cost.

Ultimate parent company

The Company is a wholly-owned subsidiary of WNZCBHL.

WNZL is considered to control WNZCBHL and the Company based on certain contractual arrangements existing between the Company and WNZL, and as such both WNZCBHL and the Company are consolidated within the financial statements of WNZL Banking Group (i.e. WNZL and its controlled entities). WNZL's Disclosure Statement is available, free of charge, at www.westpac.co.nz. WNZL is an indirectly wholly-owned subsidiary of Westpac Banking Corporation ('**WBC**'), (the ultimate parent company), which is incorporated in Australia and whose financial statements are available, free of charge, at www.westpac.com.au.

Nature of transactions

The Company is a special purpose entity which was established to purchase and hold housing loans and to provide a financial guarantee in respect of the covered bonds issued from time to time by WSNZL under the CB Programme. All proceeds from covered bonds issued by WSNZL are on-lent to WNZL. WSNZL is an indirectly wholly-owned subsidiary of WNZL. Investors in covered bonds issued by WSNZL also have recourse: first, to WNZL as WNZL guarantees all the covered bonds issued by WSNZL and second, to the Company as the Company guarantees the covered bonds issued by WSNZL and supports the guarantee by granting security over the assets it holds.

The Company's portfolio was funded by WNZL pursuant to an intercompany loan and is non-cash related. The balance of the intercompany loan has remained at $7.5 billion (2017: $7.5 billion).

The Company is a party to a contingent swap agreement, with NZ Branch as the counterparty, such that in the event that a notice to pay the guaranteed amount under the CB Programme is served on the Company, the Company is hedged against currency and other risks in respect of amounts it receives under the current structure and the amounts that may become payable in respect of the obligations under the guarantee agreement.

Pursuant to the Mortgage Sale Agreement between WNZL and the Company, the Company pays an asset performance fee to WNZL for the quality and asset generating performance of the housing loans. This enables WNZL to obtain a majority (99.75%) of the benefits of the Company's activities, i.e. to recognise the servicing or maintenance of the housing loans in the cover pool. The performance fee is calculated net of any impairment losses on the cover pool. The remaining balance of 0.25% is available for distribution to the owners of the Company subject to the dividend policy disclosed in note 7.

To manage the interest rate mismatch between the underlying cover pool and the intercompany loan, the Company entered into an interest rate swap agreement with WNZL to exchange the combination of fixed and floating rate interest received on the underlying pool of housing loans for Bank Bill Reference Rate ('**BKBM**') plus margin. The interest rate swap agreement is treated as part of the overall deemed loan in accordance with the accounting policies outlined in the accounting policy section above.

Loan finance, current account banking facilities and other financial products are provided by WNZL to the Company on normal commercial terms.

The Company received interest income on cash deposits with WNZL.

The Company received interest income on the underlying cover pool. The outstanding balance from the underlying cover pool at year end is included in Loan - principal and the outstanding balance of accrued interest receivable at year end is included in Loan - accrued interest receivable.

The Company received a guarantee fee from WSNZL for providing the financial guarantee in respect of WSNZL's obligations under the CB Programme. The outstanding balance at year end is included in Accrued guarantee fee income.

The Company paid interest expense on the loan made by WNZL to the Company to enable the Company to fund the purchase of the cover pool. The outstanding balance of the loan from WNZL at year end is included in Loan payable and the outstanding balance of accrued interest payable at year end is included in Loan - accrued interest payable.

The Company paid fees under the contingent swap agreement with NZ Branch. The outstanding balance at year end is included in Accrued contingent swap fee payable. The fair value of the contingent swap agreement as at year end is nil (2017: nil).

Management fees are charged by Westpac Securitisation Management Pty Limited ('**WSM**'), as the servicer and cash manager. WSM, an Australian company, is an indirectly wholly-owned subsidiary of WBC. The outstanding balance at year end is included in Payables due to related entities - Other.

Security trustee fees are paid to NZGT (WNZCB) Security Trustee Limited which is a wholly-owned subsidiary of The New Zealand Guardian Trust Company Limited ('**NZGT**'). The outstanding balance at year end is nil (2017: nil). NZGT, as a trustee for a charitable trust, owns 81% of WNZCBHL's ordinary shares.

The audit fees for the current year and prior year have been borne by WNZL, refer to Note 5.

Transactions with related entities are arranged on an arm's length basis.

The Company paid dividends in the current and prior year to its parent entity, refer to Note 7.

pwc

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 8. Related entities (continued)

Transactions with related entities

	Note	2018 $'000	2017 $'000
Dividend paid to WNZCBHL	7	100	99
Income			
Interest income from cash deposits with WNZL[1]		14,324	14,456
Interest income from cover pool[1]		207,914	220,221
Guarantee fee from WSNZL[2]	3	12,851	10,889
Total income		235,089	245,566
Expenses			
Interest expense on loan from WNZL[3]	2	233,218	243,810
Management fees charged by WSM[4]	4	750	750
Security trustee fees charged[4]	4	94	98
Contingent swap fee expense with NZ Branch [4]	4	771	653
Total expenses		234,833	245,311

[1] Included in interest income in the statement of comprehensive income
[2] Included in non-interest income in the statement of comprehensive income
[3] Included in interest expense in the statement of comprehensive income
[4] Included in operating expenses in the statement of comprehensive income

Due from and to related entities

	2018 $'000	2017 $'000
Cash and cash equivalents		
Deposits held with WNZL	1,179,847	1,266,948
Total cash and cash equivalents	1,179,847	1,266,948
Receivables due from related entities		
Loan - principal with WNZL	6,321,915	6,235,009
Loan - accrued interest receivable with WNZL	16,373	16,895
Accrued guarantee fee income with WSNZL	1,056	1,056
Total receivables due from related entities	6,339,344	6,252,960
Total receivables due from related entities including cash and cash equivalents	7,519,191	7,519,908
Settlement profile:		
Amounts expected to be settled within 12 months	1,567,667	1,658,825
Amounts expected to be settled after 12 months	5,951,524	5,861,083
Total receivables due from related entities including cash and cash equivalents	7,519,191	7,519,908
Payables due to related entities		
Loan payable to WNZL	7,500,000	7,500,000
Loan - accrued interest payable to WNZL	18,925	19,664
Accrued contingent swap fee payable to NZ Branch	63	63
Other - payable to WSM	62	62
Total payables due to related entities	7,519,050	7,519,789
Settlement profile:		
Amounts expected to be settled within 12 months	19,050	19,789
Amounts expected to be settled after 12 months	7,500,000	7,500,000
Total payables due to related entities	7,519,050	7,519,789

The underlying pool of housing loans did not qualify for derecognition in the financial statements of WNZL in accordance with the accounting policies outlined in note 1, thus the same pool was not recognised in the Company's financial statements.

Loan advances are interest bearing and interest is charged on normal commercial terms. Non-loan related amounts owing to related entities are normally settled within 90 days. Other amounts due are in relation to services provided and are settled in accordance with the terms of the transaction.

Key management personnel compensation

Key management personnel is defined as being Directors of the Company. Short term compensation of $31,045 was paid by the Company to its independent Director during the year (2017: $31,000) The Company did not make any payments to Directors who are employees of WNZL.

Note 9. Financial risk management

Holders of the covered bonds issued by WSNZL have dual recourse: first, to WNZL as WNZL guarantees all the debt securities issued by WSNZL and second, (as a result of the Company's financial guarantee of the covered bonds issued by WSNZL) to the cover pool owned by the Company.

The Company's business activities expose it to a range of financial risks.

Classification: PROTECTED

Westpac NZ Covered Bond Limited

Notes to the financial statements

Note 9. Financial risk management (continued)

Categories of financial risk

The key financial risks that the Company is exposed to are discussed below:

- Credit risk: the risk of financial loss where a customer or counterparty fails to meet their financial obligations;
- Market risk: the risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates and interest rates;
- Liquidity risk: the risk that the Company will not be able to fund assets and meet obligations as they come due.

The Company is exposed to market risk in the form of interest rate risk and currency risk. The Company is subject to interest rate risk when changes in market interest rates adversely impact the Company's floating rate payment obligations and also the fair value interest rate risk associated with the fixed rate loans included in the cover pool. Currency risk is only a factor in the event WNZL is unable to honour its obligations under the financial guarantee. If this were to occur, then under the terms of the covered bond guarantee, the Company is required to make the necessary payments to the investors in the currency the covered bonds were originally issued. To mitigate this risk the Company entered into a contingent swap agreement with NZ Branch.

The Company will be exposed to liquidity risk if any of the loans in the cover pool become impaired as any reduction in the expected cash flows collected from WNZL may result in the Company not having sufficient cash to meet its payment obligations under the intercompany loan it has with WNZL.

Additional details surrounding the risk management activities relating to the management of the financial risks are discussed below.

a. Credit risk

Credit risk is the potential for financial loss where a customer or counterparty fails to meet their financial obligations. This arises primarily from the housing loans held by the Company and the ability of the customers to meet their loan payment obligations.

The following policies and procedures are in place to mitigate the Company's exposure to credit risk:

The Company's credit risk policy involves a number of key processes and controls designed to ensure the cover pool maintains its AAA rating and remains free of any impairment. These key processes and controls include:

- The Servicer and Cash Manager (WSM) participate in monthly meetings to review key reports such as Covered Bond Asset Coverage Tests and to monitor key triggers and forecasts and discuss any critical issues such as possible changes to ratings and rating methodologies.
- Collecting and enforcing housing loan repayments in accordance with WNZL's general lending policies and identifying the loans that will be offered to sell back to WNZL. The Securitisation Trust Management team (a business unit of WBC), periodically arranges for WNZL to repurchase any loans that are more than 90 days in arrears from the cover pool and replaces them with a good/satisfactory credit rated equivalent loan. Under the terms of the contractual arrangements between the Company and WNZL, WNZL is not obliged to repurchase any loan sold to and held by the Company except where (i) it is discovered that there has been a material breach of a sale warranty (or any such sale warranty is materially untrue); (ii) the loan becomes materially impaired or is enforced prior to the second monthly covered bond payment date falling after the assignment of the loan; or (iii) at the cut-off date relating to the loan, there were arrears of interest and that loan subsequently becomes a delinquent loan prior to the second monthly covered bond payment date falling after the assignment of the loan. Before a replacement loan can be added to the cover pool it must first meet the eligibility criteria outlined in the Mortgage Sale Agreement between the Company and WNZL.
- Covered Bond Assets Coverage Reports are sent monthly to rating agencies and other parties to the covered bond transaction. The external rating agencies will also undertake an annual due diligence review of the covered bond transaction.

(i) Credit quality, impaired assets and provisions for impairment charges on loans

The following table provides an analysis of the credit quality of the Company's due from related entities balance.

	2018 $'000	2017 $'000
Neither past due nor impaired[1]		
Strong	3,458,462	3,344,785
Good/Satisfactory	2,814,263	2,831,168
Weak	-	1,270
Total neither past due nor impaired	6,272,725	6,177,223
Past due assets but not impaired		
Less than 30 days past due	63,386	71,772
At least 30 days but less than 60 days past due	2,765	2,633
At least 60 days but less than 90 days past due	468	1,332
Total past due assets but not impaired	66,619	75,737
Individually impaired assets		
Balance at beginning of the year	-	15
Additions	16	226
Returned to performing or repaid	(16)	(241)
Balance at the end of the year	-	-
Total provision for impairment charges	-	-
Total net loans	6,339,344	6,252,960

[1] The Company adopts the same internal credit rating system as applied by WNZL for the retail (program-managed) portfolios where the underlying housing loans are segmented into pools of similar risk. Each segment is assigned a quantified measure of its probability of default ('PD') for the Company. For neither Past Due Nor Impaired facilities, if the PD attached to a loan is the equivalent to an A, B, or C risk grade the loan is graded as 'strong'. If it is equivalent to D then it is graded as 'good/satisfactory' and if it is E or below then it is graded 'weak'.

Notes to the financial statements

Note 9. Financial risk management (continued)

(ii) Loans by collateral

The following analysis shows management's assessment of the coverage provided by collateral held in support of the loan balance. The estimated realisable value of collateral held is based on a combination of:

- formal valuations currently held in respect of such collateral; and
- management's assessment of the estimated realisable value of all collateral held given its experience with similar types of assets in similar situations and the circumstances peculiar to the subject collateral.

This analysis also takes into consideration any other relevant knowledge available to management at the time. It is current practice to obtain updated valuations when either management considers that it cannot satisfactorily estimate a realisable value or when it is determined to be necessary to move to a forced sale of the collateral.

In the table below, a loan is deemed to be 'fully secured' where the ratio of the loan amount to our current estimated net present value of the realisable collateral is less than or equal to 100%. Such assets are deemed to be 'partially secured' when this ratio exceeds 100% but not more than 150%, and 'unsecured' when either no security is held or where the secured loan to estimated recoverable value exceeds 150%.

	2018 %	2017 %
Fully secured	99	99
Partially secured	1	1
Unsecured	-	-
Total net loans	100	100

(iii) Concentration of credit risk

The concentration of credit risk for the Company arises from its Due from related entities, which represents the underlying pool of housing loans. Each housing loan is secured over a mortgaged property located in New Zealand. The Company is entitled to the cash flows from this collateral in the event the underlying borrowers default and the mortgaged property is subsequently sold.

b. Market risk

Market risk is the potential for loss arising from adverse movements in the level and volatility of market factors such as foreign exchange rates and interest rates. The Company is primarily exposed to interest rate risk and foreign currency risk.

i) Interest rate risk

Interest rate risk is the potential loss arising from the changes in the value of financial instruments due to changes in market interest rates or their implied volatility. Financial instruments with floating rate interest expose the Company to cash flow interest rate risk, whereas financial instruments with fixed rate interest expose the Company to fair value interest rate risk.

The Company is exposed to interest rate risk associated with the fixed and floating rate housing loans that make up the underlying cover pool. Additionally, the intercompany loan exposes the Company to a floating interest rate risk (BKBM plus margin). To manage the interest rate mismatch between the underlying cover pool and the intercompany loan, the Company entered into an interest rate swap agreement with WNZL to exchange the combination of fixed and floating rate interest received on the underlying pool of housing loans for BKBM plus margin. The interest rate swap is designed to ensure that all amounts received by the Company under the interest rate swap will enable the Company to meet its obligations. Therefore there is no material unmatched interest rate risk in the Company and any changes in market interest rates will not materially affect the statement of comprehensive income and equity of the Company.

ii) Currency risk

The Company is currently not exposed to any currency risk as the loans in the cover pool and the intercompany loan payable to WNZL are denominated in New Zealand dollars. However, in the event WSNZL or WNZL is unable to meet its commitments such that the guarantee is called by the covered bond noteholders against the Company, the Company would be required to pay the investors in the currency the covered bonds were issued. The possibility of this 'trigger' event occurring is deemed to be remote given WNZL is an AA- rated financial institution. However, if the trigger event were to occur any currency risk is managed through the contingent swap agreement the Company has in place with NZ Branch. The contingent swap will enable the Company to exchange its New Zealand dollar cash flows received from the underlying pool of housing loans for foreign currency required to satisfy the obligations to the covered bond noteholders.

c. Liquidity risk

Liquidity risk is the risk that the Company will not be able to fund assets and meet obligations as they come due, without incurring unacceptable losses.

The liquidity risk within the Company is its inability to meet its payment obligations under the terms of the intercompany loan on a timely basis. This risk is managed through the use of an interest rate swap discussed in the interest rate risk section above.

The portion of the intercompany loan repayable on demand by WNZL as at 30 September 2018 is $1,554,137,138 (Sep 2017: $1,746,867,595). This represents the balance in excess of the minimum amount required to be held contractually to maintain asset coverage for the purposes of the covered bond guarantee. The remaining portion of the loan has no fixed contractual maturity. There is a bilateral netting agreement in place to mitigate any material liquidity risk arising between the Company and WNZL.

WNZL has indemnified the Company for any payments required to be made under the guarantee (the 'indemnity amount'). The indemnity amount is paid first by reducing the intercompany loan payable and then the payment of any shortfall under the guarantee.

Notes to the financial statements

Note 10. Fair value of financial instruments

Accounting policy

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument unless there is observable information from an active market to the contrary. Where unobservable information is used, the difference between the transaction price and the fair value (day one profit or loss) is only recognised in profit or loss when the inputs become observable, or over the life of the instrument.

Critical accounting assumptions and estimates

As mentioned in Note 8, the Company has entered into a contingent swap agreement with the NZ Branch. The fair value of the contingent swap agreement as at balance date is nil as the likelihood of the swap ever being activated is considered remote (2017: nil).

Financial instruments not measured at fair value

Fair value of financial instruments has been determined as follows:

Receivables due from related entities

As discussed in Note 8, included as part of the deemed loan balance is the interest rate swap entered into by the Company and WNZL. This interest rate swap is not accounted for separately. The interest rate swap, which is repriced on a monthly basis, converts the fixed and floating interest received from the underlying pool of housing loans to BKBM plus margin. As the loan balance and the interest rate swap are not accounted for separately, this implies that the carrying value approximates the fair value.

Also included in Receivables due from related entities is the guarantee fee receivable due from WSNZL. The carrying amount of this receivable is a reasonable approximation of fair value as it is short-term in nature.

Payables due to related entities

The interest rate on the intercompany loan is a floating rate determined by WNZL as intercompany loan provider. The intercompany loan is repriced on a monthly basis therefore its carrying value approximates its fair value. The carrying value of accrued security trustee fees and the accrued covered bond swap payable are a reasonable approximation of fair value as they are short-term in nature.

For cash and cash equivalents, accrued interest receivable and accrued guarantee fee income included in due from related parties, accrued interest payable and accrued contingent swap fee included in due to related entities, which are carried at amortised cost, the carrying amount is equivalent to fair value. These items are either short-term in nature or reprice frequently, and are of a high credit rating.

Note 11. Reconciliation of net cash (used in) / provided by operating activities to net profit for the year

	2018 $'000	2017 $'000
Net profit for the year	122	117
Adjustments:		
Movement of accrued income in receivable due from related entities	522	2,049
Movement of accrued expenses in payable due to related entities	(739)	(1,492)
Net cash (used in) / provided by operating activities	(95)	674

Note 12. Capital

There are no externally imposed capital requirements on the Company. The Company is a wholly-owned subsidiary of WNZCBHL which itself is a part of the banking group made up of WNZL and its controlled entities (referred to in WNZL's Disclosure Statement as the 'Banking Group'). Capital for the Company is managed as part of the Banking Group.

Note 13. Contingent assets, contingent liabilities and commitments

Other than the guarantee requirements in Note 8, there were no contingent assets, contingent liabilities or unrecognised contractual commitments as at 30 September 2018 (2017: nil).

pwc

Independent auditor's report

To the shareholder of Westpac NZ Covered Bond Limited

The financial statements comprise:

- the balance sheet as at 30 September 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements.

Our opinion

In our opinion, the financial statements of Westpac NZ Covered Bond Limited (the Company), present fairly, in all material respects, the financial position of the Company as at 30 September 2018, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs NZ) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Company in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* (PES 1) issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our firm carries out other services for the Company in the areas of other assurance services and agreed procedures relating to the issuance of comfort letters on debt issuance programmes and other regulatory and compliance matters. The provision of these other services has not impaired our independence as auditor of the Company.

Information other than the financial statements and auditor's report

The Directors are responsible for the annual report. Our opinion on the financial statements does not cover the other information included in the annual report and we do not, express any form of assurance conclusion on the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements

The Directors are responsible, on behalf of the Company, for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-6/

This description forms part of our auditor's report.

Who we report to

This report is made solely to the Company's shareholder. Our audit work has been undertaken so that we might state those matters which we are required to state to them in an auditor's 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 Company and the Company's shareholder for our audit work, for this report or for the opinions we have formed.

The engagement partner on the audit resulting in this independent auditor's report is Jonathan Freeman.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
4 December 2018

Auckland