

BANKING

Major Australian Banks: Year End 2009

Financial Institutions
Performance Summary

FINANCIAL SERVICES



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At a glance

	ANZ		CBA ¹		NAB		WBC	
	FY09	FY08	FY09	FY08	FY09	FY08	FY09	FY08
Ranking								
By profit before tax	4	4	2	2	3	3	1	1
By total assets	4	4	2	3	1	1	3	2
By total equity	3	2	4	4	1	1	2	3
By market capitalisation	4	4	1	1	3	2	2	3
By Tier 1 capital ratio	1	3	4	1	2	4	3	2
Profit before tax (\$ million)	4,380	4,515	6,449	6,255	4,983	4,574	6,723	7,213
Profit after tax (\$ million)²	2,943	3,319	4,723	4,791	2,589	4,536	3,609	5,047
Cash profit after tax (\$ million)	3,383	3,029	4,415	4,733	3,841	3,919	4,627	5,047
Net interest margin (basis points)	229	201	210	202	216	220	232	202
Cost to income ratio (percent)	45.7	46.8	43.4	48.2	43.9	46.9	38.5	42.3
Loan impairment charge (\$ million)³	2,985	1,850	2,683	930	3,815	2,703	3,292	1,205
Basic earnings per share – statutory basis (cents)	131.0	170.4	328.5	363.0	123.4	262.7	162.0	198.3
Basic earnings per share – cash basis (cents)	150.8	155.3	305.6	356.9	198.4	238.4	125.3	206.0
Return on equity (percent) – cash basis	12.0	13.2	15.8	20.4	11.8	14.3	13.8	22.3
Impaired loans to loans and advances to customers (percent)	1.30	0.51	0.89	0.19	1.44	0.56	0.84	0.32
Collective provision to credit RWA (percent)⁴	1.31	1.13	1.24	0.77	0.94	0.75	1.42	1.05
Total assets (\$ million)	476,987	470,293	620,372	487,572	654,120	656,799	589,587	587,114
Total equity (\$ million)	32,429	26,552	31,442	26,137	37,835	32,846	36,571	26,474
Capital Adequacy Ratios (percent)								
- Total	13.70	11.10	10.42	11.58	11.48	10.93	10.80	10.80
- Tier 1	10.60	7.70	8.07	8.17	8.96	7.35	8.10	7.80
Market capitalisation (\$ million)⁵	61,081	38,262	78,598	56,521	64,468	41,675	77,200	40,689

Summary

“The global recovery is likely to be drawn-out, fragile and with possibly a few more nasty surprises in store.”



Michelle Hinchliffe
Partner, Head of
Financial Services

The global context

The first half of the 2009 year witnessed the most extreme stresses seen in global financial markets since the 1930's, with steep declines in equity markets, exceptionally high risk premiums being demanded in all markets and indeed effective closure of some markets, particularly wholesale credit markets.

In the second half, systemic risks in the global economy and global financial markets have reduced substantially following unprecedented and coordinated policy actions by governments and regulators around the world and emerging signs of improvement in the real economy. Nonetheless, the real and financial sectors remain under considerable strain and households and financial institutions need to continue to reduce leverage.

Markets often over-react. Sentiment can turn from confidence to despair, and back again, with little apparent cause. The global economy has experienced a severe shock, but those predicting the end of capitalism as we know it were overly pessimistic. Equally, the chorus of commentators now pointing to signs of recovery, green shoots, corners being turned, are probably overstating the prospects for any early return to the good times. The global recovery is likely to be drawn-out, fragile and with possibly a few more nasty surprises in store.

Some commentators now believe that complacency may become a risk – banking system problems could go unresolved and substantive regulatory reforms may be delayed or diluted. Governments around the world need to provide a plan for the future regulatory framework that mitigates the build-up of systemic risks, grounds expectations, and underpins confidence, thereby allowing financial institutions to wean themselves off government support as quickly as possible.

Retail banking is still profitable, but at lower levels (to pre-crisis), with rising impairments still hurting many banks globally. It seems probable that some will fall into loss making in 2009. It is expected that a high level of impairment is likely to continue for the foreseeable future. The financial system is going through massive de-leveraging, with many banks in particular having lower leverage. The implication for banks is that the profitability metrics (like returns on equity and return on assets) will be lower than in recent years.

“Major Australian banks have continued to report solid profits, have further strengthened their capital positions and have maintained their high credit rating.”



Andrew Dickinson
Partner, Head of
Banking

The Australian context

Although far from immune from the crisis in global financial markets, the major Australian banks have been largely sheltered from the near death experiences of many international banks. They have continued to report solid profits, have further strengthened their capital positions, and have maintained their high credit ratings. Funding conditions have also improved and all banks have recommenced the issuance of debt which is not supported by the government guarantee.

A number of interrelated factors have contributed to the robust performance of the Australian banking system in the face of the GFC. One is that Australian banks typically had very limited direct exposures to the types of securities – such as CDOs and US sub-prime RMBS – that led to losses for many banks abroad. Credit policies generally were more conservative in Australia, as many Australian banks had not yet forgotten the lessons learnt so painfully in the recession of the early 1990’s, which hit our banks harder than those overseas. Generally, they did not typically rely on the income streams most affected by recent market conditions: trading income only accounted for around 5 per cent of the major banks’ total income prior to the turmoil. Australian banks were also by and large better capitalised and more conservatively geared than many banks overseas, and have also benefited from a very strong Australian economy in world terms. Finally, it is fair to say that the Australian regulatory model and the Australian regulators performed more vigilantly than many overseas.

While the statutory profits of Australian banks have declined modestly, this essentially reflects increased provisioning charges, with underlying core earnings remaining very strong. The major banks have benefited from a flight to quality in funding markets, which has allowed them to increase significantly their market share of both deposits and lending, and have also been able to reverse the longstanding trend of declining net interest margins. In this environment, it is perhaps unsurprising that the big 4 Australian banks now represent four of only nine banks globally rated AA or better by Standard and Poors.

In such a climate, the Australian banks will now turn their attention to life after the crisis. It is unlikely to be a return to business as usual, at least as we used to know it.

CBA and Westpac finalised acquisitions of BankWest and St George respectively in early 2009 followed by ANZ and NAB announcing major acquisitions late in 2009. Future acquisition opportunities are likely to emerge as overseas banks deal with regulatory pressures to deleverage and exit non-core businesses.

Attitudes have changed; regulation will be tighter; for many, public perceptions will matter more; government and taxpayer support for the financial system will be necessary for some time to come. But while the landscape has changed the challenges for Australian banks should be more familiar: developing a competitive business model, managing risk, building a winning brand, successful integration of acquisitions, competing profitably and cost-effectively.



Profit

The performance by the Australian majors is buoyant when taking into account the challenges of the past year.

Profit before tax remained level at \$22.5 billion in 2009, compared to \$22.6 billion in 2008. This is a strong outcome given the significant challenges of the past year.

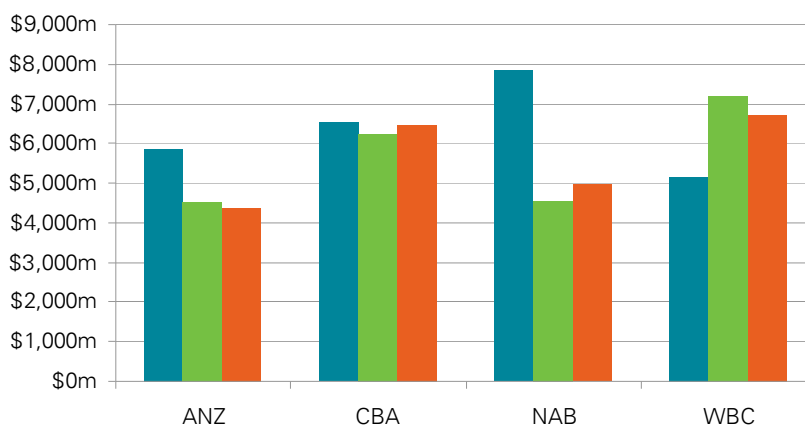
Year	Profit before tax \$ billion	Year	Profit before tax \$ billion
2009	22.5	2004	16.1
2008	22.6	2003	14.8
2007	25.4	2002	13.8
2006	22.9	2001	12.8
2005	20.0	2000	13.6

Significant items impacting the 2009 results include:

- Credit impairment charges increased significantly compared to the previous year: ANZ \$3,005 million (2008 - \$1,948 million), CBA \$3,048 million (2008 - \$930 million), NAB \$3,815 million (2008 - \$2,703 million), and WBC \$3,292 million (2008 - \$1,205 million). These increases, which represent a 94 percent increase on the prior year, were due to both individually identified corporate exposures and greater collective provisioning, reflecting the continued overall deterioration in credit markets.
- Fair value gains/losses on revaluing own debt and other movements arising from use of fair value option and hedge accounting included:
 - ANZ - \$358 million loss (2008 - \$348 million)
 - NAB - \$115 million loss (2008 - \$119 million loss)
- Strong income growth from markets operations as the majors capitalised on significant interest rate and foreign exchange volatility and generated increased profits from both customer flow business and proprietary trading:
 - ANZ - \$2,191 million (2008 - \$1,241 million)
 - CBA - \$741 million (2008 - \$546 million)
 - NAB - \$828 million (2008 - \$148 million loss)
 - WBC - \$1,014 million (2008 - \$851 million)
- CBA recorded a \$983 million gain on its acquisition of a 100 percent interest in Bank of Western Australia Ltd, St Andrew's Australia Pty Ltd and HBOSA Group (Services) Pty Ltd.

Profit before tax and provisions of \$35.7 billion is up 21.8 percent on 2008 (\$29.3 billion).

Profit before tax



Source: KPMG ■ Sep-07 ■ Sep-08 ■ Sep-09

During 2009, WBC acquired St George Bank. Unless stated, we have used proforma information provided within the WBC 2009 results which has presented current period and comparative information for the combined entity. Also during 2009, CBA acquired BankWest, however, the acquisition of BankWest by CBA has not been as material to the results of the CBA group. Accordingly comparative information in this report excludes the impact of BankWest.

Profit before tax and provisions

The underlying business of all the banks remained robust, and excluding credit impairment charges, profit before tax and provisions increased by 21.8 percent in 2009 compared to 2008.

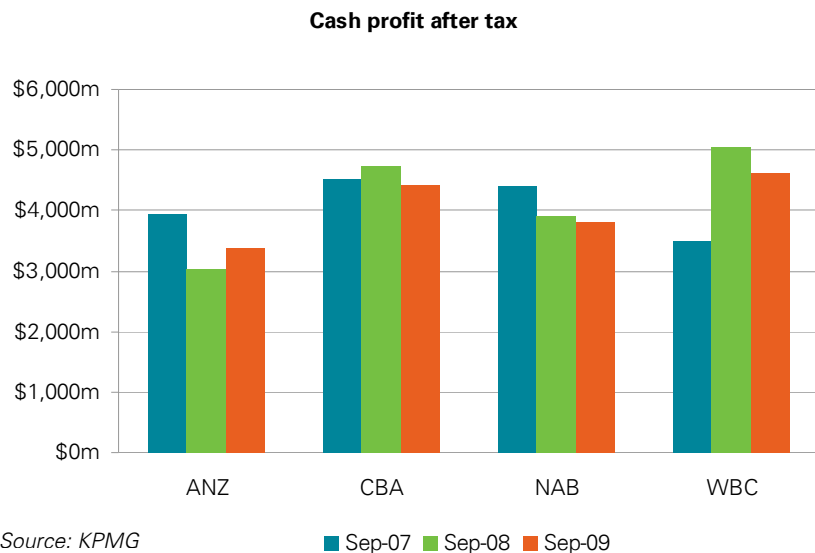
Profit before tax and provisions



Source: KPMG ■ Sep-07 ■ Sep-08 ■ Sep-09

Cash profit

Using the industry preferred cash profit (after tax) basis, the performance of the majors for the year was \$16.3 billion (2008 - \$16.7 billion).



Cash earnings as reconciled below are based on the majors' profit announcement and generally exclude significant items, non-core items, and certain accounting adjustments which cause earnings volatility (for example, mark to market of certain hedge gains and losses, and use of the fair value option). These numbers should be viewed with caution given the differing treatments adopted by the majors in determining cash profit.

	ANZ \$ million	CBA \$ million	NAB \$ million	WBC \$ million
Statutory profit after tax	2,943	4,723	2,589	3,446
Adjustments to statutory profit:				
St George pre merger earnings	-	-	-	163
Tax on NZ conduit transactions	196	-	542	703
Tax - other	-	-	309	-
Restructuring costs	17	78	197	234
Fair value adjustments	227	245	79	(8)
Provision for litigation	-	-	110	-
Treasury shares	-	28	256	32
Gain on acquisition	-	(612)	-	-
Distributions of other equity	-	-	(245)	-
Other	-	(47)	4	57
Cash profit	3,383	4,415	3,841	4,627

Profit after tax

Profit after tax decreased by 15.9 percent to \$14.9 billion in 2009 compared to \$17.7 billion in 2008.

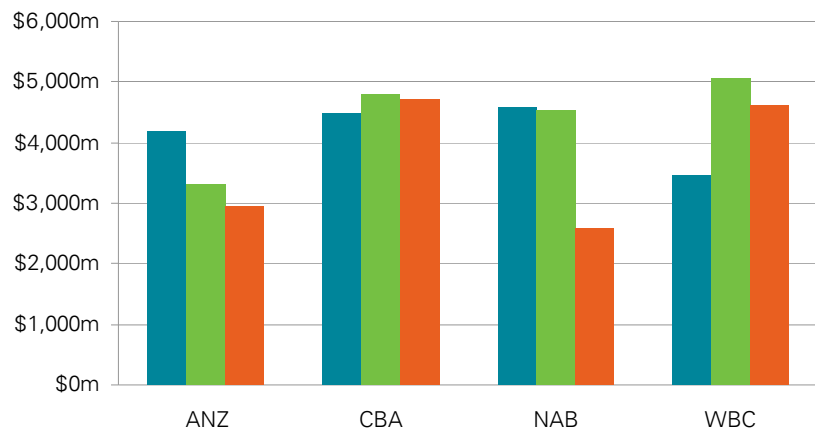
Significant tax charges were taken by the majors in 2009 in response to developments in both Australia and New Zealand following action taken by the tax authorities in both countries.

After New Zealand High Court rulings late in the year, the majors, with the exception of CBA (who reported results to June 2009), recorded income tax expenses relating to certain structured transactions totalling:

- ANZ - \$196 million
- NAB - \$542 million
- WBC - \$703 million

In addition the NAB have recognised a further \$309 million income tax expense in relation to certain structured transactions in Australia (ExCaps taxation assessment).

Statutory profit after tax



Source: KPMG

■ Sep-07 ■ Sep-08 ■ Sep-09

Credit provisions have almost doubled as the majors signalled a prudent approach to provisioning.

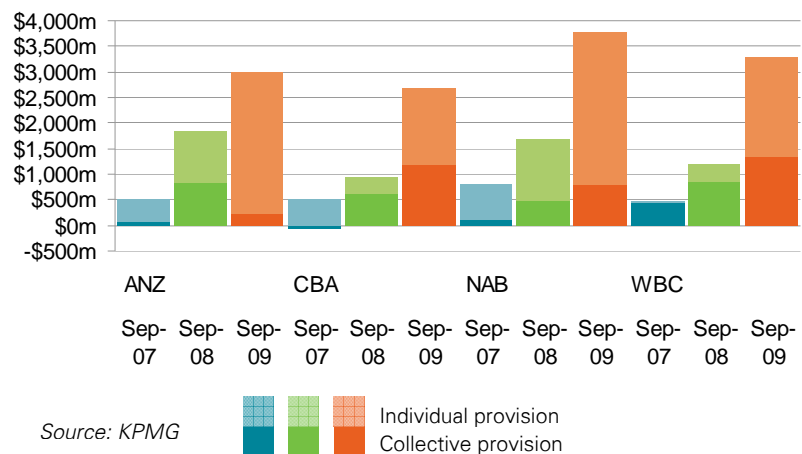
Asset quality

The credit impairment charge increased by 94.1 percent to \$13.2 billion compared to \$6.8 billion in 2008.

This increase reflects the cyclical deterioration in portfolio quality. Each of the majors has reported a prudent approach to provisioning has been adopted and have signalled signs of stabilisation in portfolio deterioration. However, they appear to remain cautious as to how the credit cycle will play out in 2010.

Individual provision charges increased from \$2.1 billion in 2008 to \$5.9 billion in 2009 resulting from a number of specific large corporate exposures as well as an increase in losses within the retail and SME sectors.

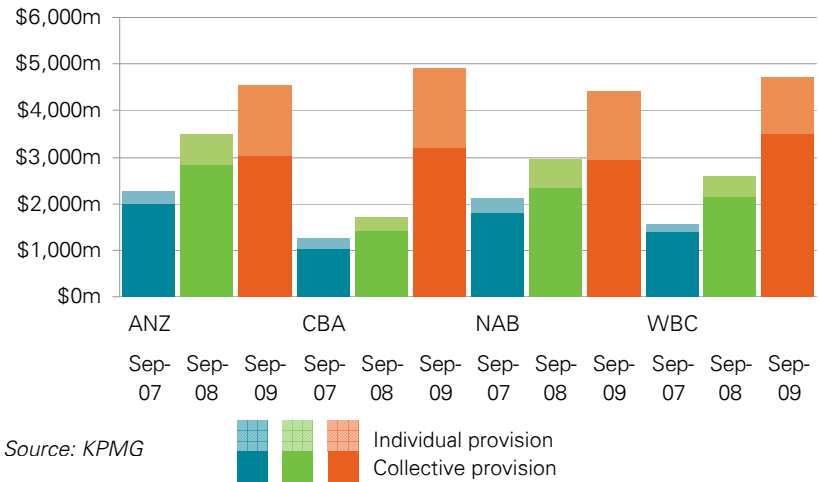
Loan credit impairment charge



Year	Impairment charge \$ billion	Year	Impairment charge \$ billion
2009	13.2	2004	1.9
2008	6.8	2003	2.0
2007	2.2	2002	2.5
2006	1.8	2001	2.3
2005	1.8	2000	1.5

While the majors have performed strongly in comparison to their global peers, the impact of the financial crisis is highlighted by the significant impairment charges taken in the 2008 and 2009 financial years.

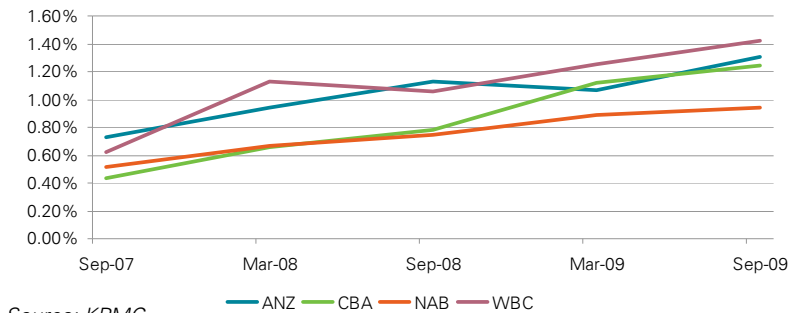
Balance sheet credit provisions



Collective provisions as a percentage of credit risk weighted assets continues to increase with the average ratio for the majors in excess of 1.2 percent.

This compares with an average of 0.93 percent at year end 2008.

Collective provisions for impairment compared to credit risk weighted assets



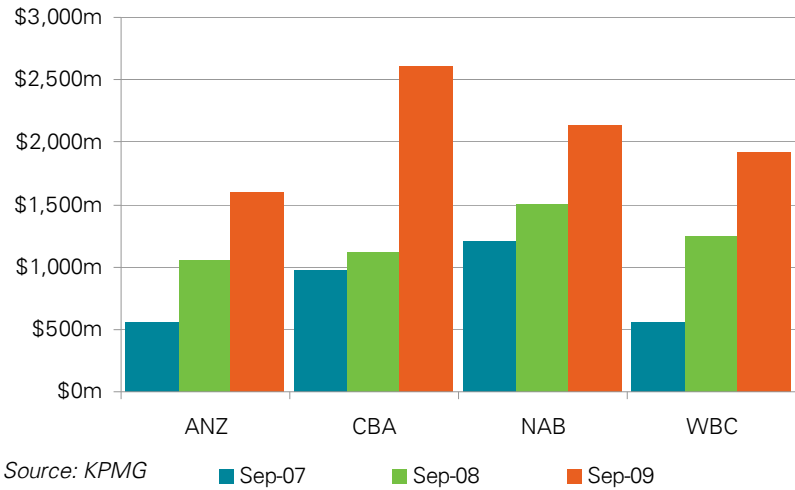
Notes:

September 2007 Credit Risk Weighted Assets calculation on Basel 1 basis.

NAB's collective provision for impairment used in the graph above does not include collective provision allocated to loans and derivatives at fair value.

CBA and WBC increased collective provisions by a further \$450 million and \$511 million respectively through fair value adjustments arising from their acquisition accounting.

Accruing loans past due 90 days or more



All the majors have experienced a significant increase in 2009 in accruing loans past due 90 days across all lending portfolios. CBA's increase is also impacted by the BankWest acquisition.



“Interest rates are likely to rise until they reach between 5 to 6 percent in two years time, which reflects a neutral stance for monetary policy”.



Brendan Rynne
Partner,
Economics
Infrastructure &
Policy

Economic Synopsis

Following several years of strong growth, the Australian economy expanded by a weak 1 percent in 2008-09. As a result of the Global Financial Crisis (GFC) consumption growth slowed from a strong 4 percent in 2007-08 to a sluggish 1.4 percent in 2008/09 and private construction investment fell in the first two quarters of 2009.

Following stronger than expected consumer spending and signs of recovery in China, it seems that the Australian economy has managed to avoid a recession. However, the next 12 months will continue to be tough. Consumption growth is still slower than normal. Some consumers are still carrying too much debt and thus a moderation in consumption is needed for a healthier household balance sheet. In addition, business investment is still expected to slump in 2009-10 as the investment pipeline dries up. Private developers in the non-residential building sector (which includes the construction of buildings such as offices, hotels and warehouse) are still finding it difficult to borrow funds for new projects.

The current weakness in output will cause employment growth to stall, leading to higher unemployment. We expect unemployment to peak at 7 percent by late 2010. The slowdown has also eliminated inflationary pressures. However, inflation will begin to pick up as economic activity gathers pace. As such, the Reserve Bank of Australia recently begun the rate tightening cycle. Interest rates are likely to rise until they reach between 5 to 6 percent in 2 years time, which reflects a neutral stance for monetary policy.

On a more positive note there are several reasons to expect the recovery phase to begin in mid-2010. Significant fiscal policy measures have been enacted which will pump-prime the economy. The government has geared its fiscal policy towards fighting the effects of the economic slowdown, announcing massive spending packages to try and limit the increase in unemployment. The short-term weakness in the labour market is reigning in wage growth and this will improve profitability and thus contribute to Australia's recovery. Interest rates remain at historically low levels and this will assist in stimulating demand. The low interest rates will also support a recovery in dwelling investment once employment stabilises and credit conditions normalise. International developments provide further reason to expect a recovery in mid-2010; with Asia expected to recover well ahead of the UK and the USA, this will provide support for Australia's commodity exports.

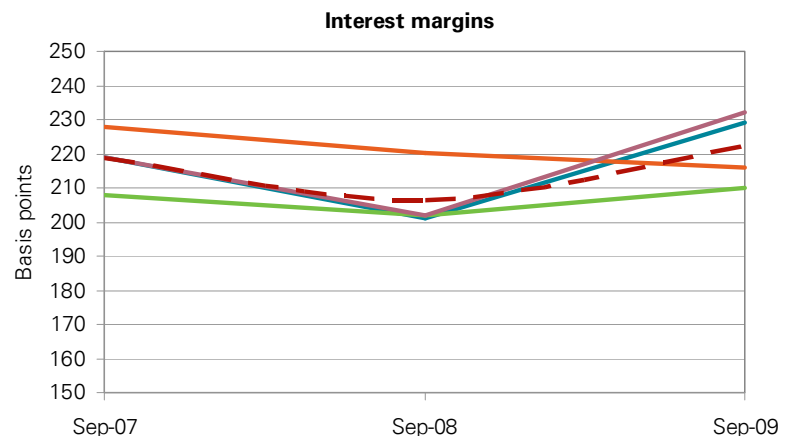
Net interest income

Net interest margin increased by 16 basis points over 2008 as assets (principally commercial) were repriced

Net interest income increased by 20.3 percent to \$43.9 billion 2009 (2008 - \$36.5 billion), compared to lending asset growth⁶ of 9.0 percent. The average net interest margin of 222 basis points increased from 206 basis points in 2008.

The majors continued the repricing for risk within their leading portfolios continuing the trend commenced in the second half of 2008. This increase is warranted given a lack of pricing for risk in prior years – a recognised major cause of the global financial crisis. Most of this repricing during 2009 has taken place in the commercial sector.

Offsetting this has been the continued margin compression resulting from intense competition for retail deposits.



Source: KPMG

— ANZ — CBA — NAB
— WBC - - Average

The net interest margin for the majors has been impacted by the geographical spread of business.

Margin basis point change	ANZ	CBA	NAB	WBC
Australia	29	8	13	18
New Zealand	13	n/a*	(29)	7
Other	47	4	(38)	n/a*
Total	28	8	(4)	30

* not available from reported information

Interest rate adjustments

As reported in our 2008 survey, a shortage of supply and an increased cost in wholesale funding resulted in the majors adjusting interest rates outside of movements in the RBA's target cash rate. The continued repricing of risk into 2009 by the majors has resulted in only a portion of the cash rate reductions announced by the RBA, being passed on to customers.

Basis point movements in RBA and bank mortgage rates during the period since September 2008 were as follows:

Months	RBA	ANZ	CBA	NAB	WBC
October 2008	(100)	(105)	(101)	(100)	(100)
November 2008	(75)	(58)	(58)	(62)	(65)
December 2008	(100)	(83)	(100)	(100)	(80)
February 2009	(100)	(100)	(100)	(100)	(100)
April 2009	(25)	(10)	(10)	0	(10)
June 2009	0	0	10	0	0
October 2009	25	25	25	25	25
November 2009	25	25	25	25	25
Total	(350)	(306)	(309)	(312)	(305)

The increased volatility, higher volumes and wider spreads in the customer flow business have assisted the majors in reporting strong trading revenues

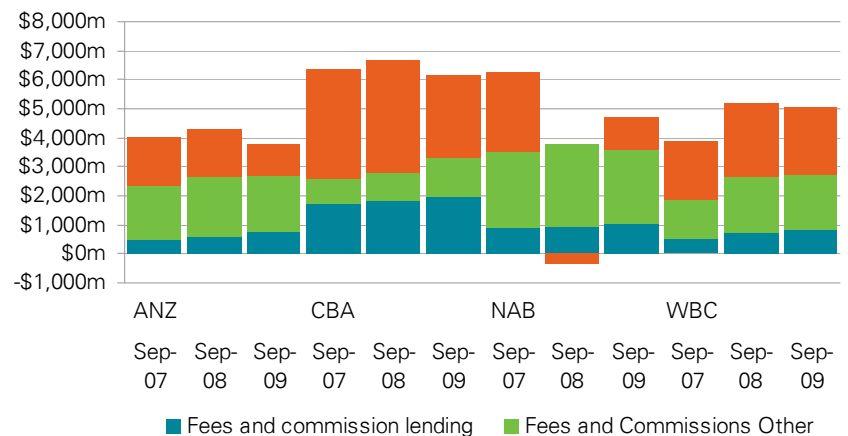
Non-interest income

Non-interest income was relatively flat at \$19.7 billion in 2009 compared to \$19.6 billion in 2008.

Some of the contributors to this higher level of revenues include:

- Higher trading volumes due to increased market volatility
- Increased profit taking opportunities on credit market instruments
- Continued growth in both lending and non-lending fee income
- A decrease in wealth management profits (see analysis on page 18)
- Fair value movements on derivatives entered into to manage interest rate risk and foreign exchange volatility.

Breakdown of non-interest income



Source: KPMG

- During the year, the majors have all announced the removal of fees such as dishonour fees, overdrawn fees and late payment fees. The resulting reduction in income in 2010 estimated by each major is:
 - ANZ: - \$140 million
 - CBA: - \$200 million
 - NAB: - \$110 million
 - WBC: - \$210 million

“The responsible lending provisions will significantly impact the manner in which financial institutions retain and attract new customers, in particular balancing the need to perform financially with the requirement to act in compliance with the duties of being a responsible lender.”



Hilde Marais
Director, Financial
Risk Management
Advisory

National Consumer Credit Reform

The recent reform to consumer credit laws in Australia has introduced a number of significant changes to the obligations of financial institutions in offering retail lending products and services to consumers. The purpose of the reform was to establish a national consumer credit regulatory framework, offering greater protection to consumers for lending activities through improved regulation, greater sanctions and enhanced regulatory powers for the Australian Securities and Investments Commission (ASIC).

The key piece of legislation introduced through the reform is the *National Consumer Credit Protection Bill (NCCPB)*, which requires credit providers, including authorised deposit-taking institutions, to apply for registration with ASIC and to obtain an Australian Credit Licence. There are various registration and licensing requirements imposed by the Bill, including an obligation for licensed credit providers to adhere to new responsible lending provisions. This will place an additional onus on credit providers to ensure that credit is only extended to consumers under suitable conditions, having regard to the personal circumstances of the individual.

The responsible lending provisions will significantly impact the manner in which financial institutions retain and attract new customers in the realm of retail lending, particularly in balancing the need to perform financially with the requirement to act in compliance with the duties of being a responsible lender.

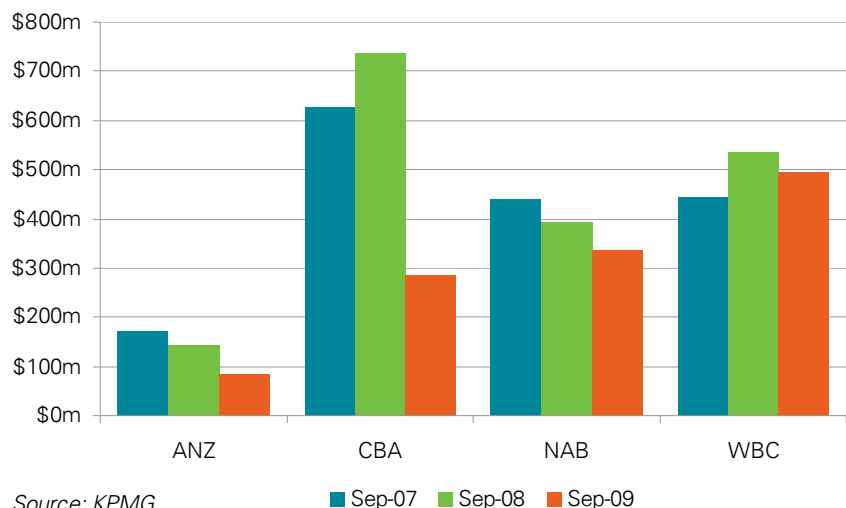
Early assessment of the impact of the legislation is critical in order for financial institutions to understand the gap by doing a detailed gap analysis between the existing and ‘to be’ state. This gap analysis should cover all aspects of the credit process, including marketing protocols, customer and internal documentation, recordkeeping, training requirements and all aspects of responsible lending. These reforms, while offering protection to consumers, will add further to the increasing regulatory burden placed on financial institutions.

Wealth management

Wealth management includes the provision of life insurance, superannuation and investment management. Wealth management profits⁷ decreased by 34.1 percent in 2009 to \$1.2 billion, compared to \$1.8 billion in 2008.

The key factor impacting performance continues to be the fall in global share indices, reducing FUM and consequently fee income throughout 2009 given the 6 month time lag in market performance flowing through to fee income. As a result of share market volatility we continue to see customers transferring more of their savings into banking deposits than the wealth management industry, leading to lower FUM. This is helped by the government guarantee in place over deposits.

Wealth management - profit

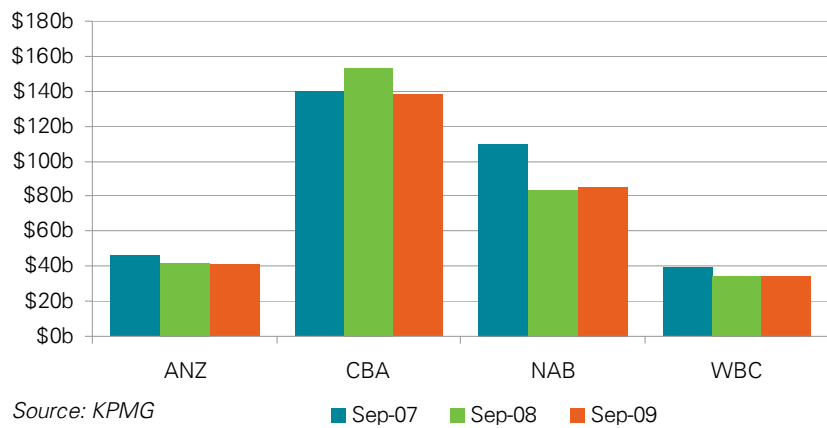


Index	Performance for 6 months to 31 Mar 2009	Performance for 6 months to 30 Sept 2009	Performance for 12 months to 30 Sept 2009
S&P 500	-32%	23%	-9%
Japan TOPIX	-29%	13%	-16%
FTSE 100	-20%	25%	5%
Hang Seng	-25%	41%	16%
S&P/ASX 200	-28%	31%	3%

The cautious return of confidence in the market has seen FUM increase in the second half of 2009, driven by both net inflows and the improvement in key indices compared to 31 March 2009.

Total FUM has decreased by 4.6 percent from \$312.6 billion to \$298.1 billion at 30 September 2009.

Wealth management - FUM



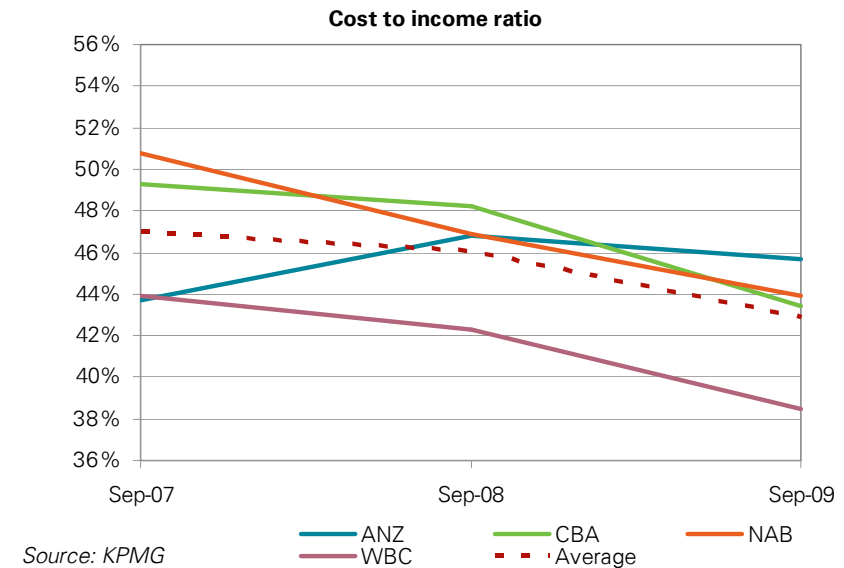
Costs

Despite difficult market conditions, the majors continued a disciplined approach to cost management with the cost to income ratio continuing to fall.

Despite difficult market conditions, an increased regulatory agenda and integration activities for two of the majors during the year, the cost to income ratio continued to fall.

Operating costs increased to \$28.9 billion in 2009, compared to \$26.8 billion in 2008. BankWest operating expenses were \$483 million for the 2009 year. Excluding these costs, operating expenses have increased by 5.9 percent.

The average cost to income ratio decreased from 46.1 percent in 2008 to 42.9 percent in 2009 with WBC achieving the lowest ratio of 38.5 percent.



As the majors look to refocus their strategies following the financial crisis, a large part of operating expenditure is being directed towards distribution capability and front-line staffing. This is consistent with increasing focus on customers.

“The credit fuelled bubble of the last 5 – 6 years has burst, resulting in a funding gap and forcing borrowers to rethink their approach to sourcing capital”



David Heathcote
National Head of Debt
Advisory

Mind the gap

Over the last 2 years, the general lack of liquidity and uncertainty within the credit markets have reshaped the Australian corporate landscape as companies awoke to the shock realisation that the credit-fuelled bubble of the last 5-6 years had burst, resulting in a funding gap and forcing borrowers to rethink their approach to sourcing capital.

Access to new loans has been difficult for many borrowers and near impossible for non-investment grade credits as reflected by syndicated loan volumes reverting to 2004 levels with only c.US\$60 billion raised in 1H09, mostly for the purposes of refinancing existing indebtedness. This has been further amplified by a flight to quality as banks implement Basel II capital reserve requirements that currently provides incentive for deployment of capital towards good quality credits and conversely effectively provides disincentives for investment in sub-investment grade borrowers, unless a significant return can be generated.

The initial shock transcended into a crisis as statistics emerged that a staggering c.US\$200 billion of Australian syndicated loans are forecast to mature over the next 4 years and an estimated \$14 billion in corporate bond issuances (excluding government and financial) will need to be refinanced or redeemed over the next 18 months.

Meeting this refinancing need will be a challenge and banking analysts have estimated that foreign banks, which have been a growing source of capital over the last 5-6 years with over 45 percent of syndicated loan market share as of 2007, will begin reducing their exposure by approximately A\$37 billion over the ensuing 3 years. August 2009 APRA statistics indicate that growth in foreign loans and advances have decreased by \$17.9 billion since December 2008 on top of the 4 percent market share loss experienced in 2008. In the context of spiralling global sovereign risk, high-profile names have withdrawn from the Australian market to focus on their own domestic franchises.

Whilst it is encouraging to see the domestic banks assisting in filling part of the refinancing gap, the increase in market share may come at a cost to existing borrowers. Already commentators have noted that major banks are enjoying healthier net interest margins than they were prior to the global financial crisis. Investment bankers also continue to enjoy strong profitability from the c\$90 billion of discounted equity issues in FY09, albeit at the cost of significantly diluting existing shareholders.

Capital adequacy

Stronger capital ratios are now expected by the market with considerable focus placed on Tier 1 ratios

The majors continue to target a strong capital position as a key priority. While facing the prospect of further significant regulatory changes (refer to Liquidity Management commentary on page 23) capital raising by all majors during 2009 has led to an increase in Tier 1 capital of 32.5 percent over 2008, increasing from \$78.5 billion to \$104.0 billion.

This resulted in an increase in the average Tier 1 ratio of 8.9 percent in 2009 compared to 7.8 percent in 2008.

	ANZ		CBA		NAB		WBC	
	FY09	FY08	FY09	FY08	FY09	FY08	FY09	FY08*
Capital Adequacy Ratios (%)								
- Total	13.70	11.10	10.42	11.58	11.48	10.93	10.80	10.80
- Tier 1	10.60	7.70	8.07	8.17	8.96	7.35	8.10	7.80
Tier 1 Capital (\$ million)	26,619	21,229	23,311	16,791	30,674	25,243	23,416	15,215
Total Capital (\$ million)	34,430	30,567	30,095	23,804	39,317	37,562	31,127	21,201
Risk weighted assets (\$ million)	252,069	275,434	288,836	205,501	342,522	343,511	288,739	195,505

*WBC 2008 comparative does not include St George

On a UK FSA comparable basis, the majors' Tier 1 ratios would increase by approximately 2 percent. On this basis, the majors' Tier 1 capital ratios compare favourably with the UK banks⁸ which reported June 2009 Tier 1 ratios of:

- Barclays – 10.5 percent
- HSBC – 10.1 percent
- RBS – 9.3 percent
- Lloyds TSB – 8.6 percent

The UK banks took significant steps during the half year to 30 June 2009 to strengthen capital ratios following significant government intervention in the banking system. It is clear that moving forward, the quantity and quality of capital required to be held by banks will be higher and counter-cyclical requirements will be imposed to make banks hold more capital in good times. What is yet unclear, is how this will work in practice.

“The proposed changes will have a significant impact on ADIs through increased infrastructure and compliance requirements, potential changes to balance sheet structures, and costs associated with implementation to hold additional liquidity buffers.”



Craig Davis
Director, Financial
Risk Management
Advisory

Liquidity Management

On 11 September 2009 APRA released its long awaited discussion paper on their proposed approach to ADI Liquidity Risk. The rules outlined in this paper reflect the principles developed by the Basel Committee on Banking Supervision (Basel) published in September 2008 as a result of the market turmoil that started in July 2007.

It has been well documented that globally, many of the exposed banks did not have an adequate framework when liquidity was plentiful. In a lot of cases the liquidity risks posed by individual products and business lines were not fully accounted for and compounding this, incentives at the business level were misaligned with the organisation's risk tolerance.

To rectify this banking regulators have leveraged off the Basel guidance and developed similar prudential requirements allowing for a global liquidity standard to be put in place. A major change resulting from these proposals is that it is no longer only the home regulators responsibility to oversee group liquidity but also the host regulator to ensure that foreign branches also meet these new requirements.

The main proposed changes to the current APRA standards are:

- extension of the 'going concern' scenario to 12 months and making it a requirement for all ADI's regardless of their size and nature of their operations
- lengthening of the time horizon for the 'name crisis' scenario from the current 5 business days to 1 month (other regulators have kept this idiosyncratic scenario to 10 working days)
- inclusion of an APRA defined 3 month 'market disruption' stress scenario
- provision of APRA defined stress test assumptions (previously all assumptions were institution defined)
- enhanced qualitative requirements including greater board responsibilities and involvement from internal audit
- a standardised reporting framework with the collection of data potentially used for publication.

In addition there is currently work being performed by the Basel Committee (of which APRA is a member of the liquidity working group) to develop a global quantitative framework for liquidity risk supervision. This may impact on some of the assumptions proposed by APRA for scenario modelling.

The changes proposed will have a significant impact on ADIs' and the banking system through increased infrastructure and compliance requirements, potential changes to balance sheet structures, and costs associated with implementation and the requirements to hold additional liquidity buffers.

APRA anticipates that it will be issuing its revised prudential standards which will come into effect in the first half of 2010. ADI's will be required to demonstrate compliance through the submission of a self-assessment by the end of December 2010 with gaps closed by the end of Q1 2011. Standardised quarterly reporting will commence from the December 2010 quarter.

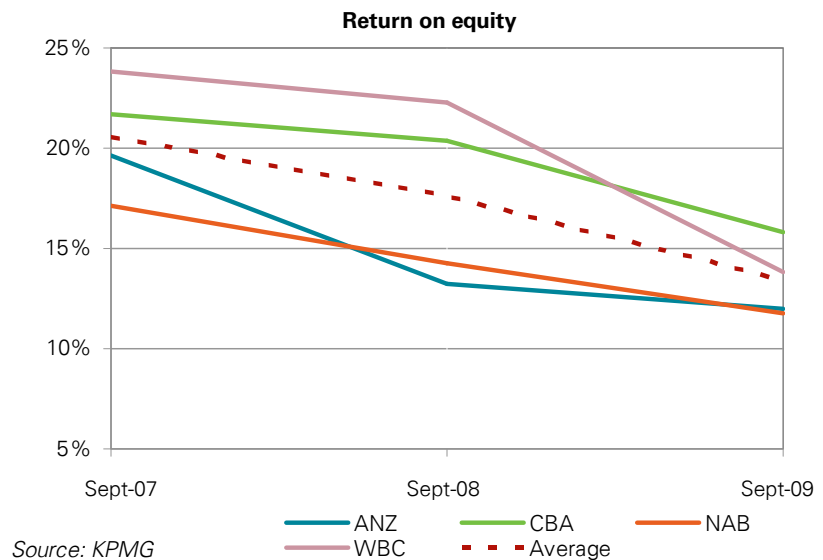
While tactically the requirements may not be a major change to how ADI's have focused on liquidity throughout the current crisis, it will impact at a strategic level given the data intensive nature of the requirements and the compliance and infrastructure initiatives needed to fulfil these prudential standards.

Return on equity

Average return on equity of 13.4 percent compares to 17.6 percent in 2008 as a result of lower profits and increased capital held by the majors.

The cash return on equity continued its downward trend during 2009 to an average of 13.4 percent compared with 17.6 percent in 2008⁹.

The decrease is much larger than the reduction in profit and is driven by the significant capital raisings each of the majors have undertaken during 2009. As reported in our prior year surveys, it is unlikely the return on equity will return to 2007 levels, given the expected impact from impending regulatory changes of increased levels of capital.



Dividends

With a continued focus on capital management and reduced profits for the year, each of the majors announced a reduction in total dividends – ANZ 25 percent, CBA 14 percent, NAB 25 percent and WBC 18 percent compared to 2008.

Share price performance

The share price volatility of the past 12 months reflected significant uncertainty over the impact of the global turmoil during the first half, followed by a rebound in the market during the second half as confidence returned to the real economy and markets.

Market capitalisation

	4 Nov 09 (\$ billion)	30 Sept 09 (\$ billion)	30 Mar 09 (\$ billion)	30 Sept 08 (\$ billion)	30 Sept 07 (\$ billion)
ANZ	56,934	61,081	33,990	38,262	55,380
CBA	78,814	78,598	52,252	56,521	73,340
NAB	58,998	64,468	38,562	41,675	64,602
WBC	75,850	77,200	55,562	40,689	53,155
SGB	n/a	n/a	n/a	16,203	18,847

Source: Bloomberg



Funding

The flight to quality by retail customers has seen the majors reduce their reliance on short term wholesale funding.

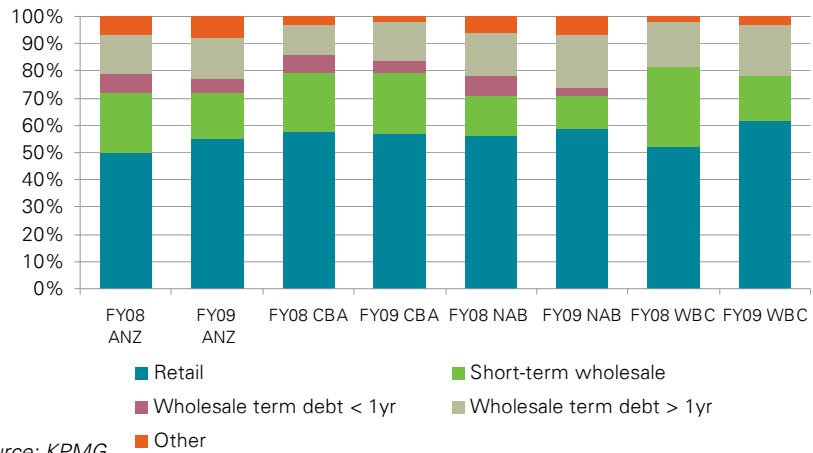
The majors continue to focus on achievement of funding targets as a key priority. This includes:

- Reducing reliance on short term wholesale debt
- Maintaining share of retail deposit market
- Executing term debt issuances well ahead of schedule.

The majors maintained their share of domestic market retail deposits at 82 percent resulting in half of their funding being sourced from retail deposits.

System growth in the Australian domestic market in 2009 for retail deposits was 14.5 percent, while the growth recorded in 2008 was 20.4 percent¹⁰. Household deposits as at 30 September 2009 totalled \$441 billion.

Funding profile



Source: KPMG

WBC do not disclose a breakdown of their wholesale term funding maturity profile. For the purposes of the graph above, all wholesale term funding has been allocated to maturity periods greater than 1 year.

Short-term wholesale funding represents on average 16.8 percent of total funding compared to 20.6 percent as at 30 September 2008, while retail deposits increased from 54.0 percent to 58.3 percent.

The majority of wholesale funding sourced during 2009 was with the government guarantee. In 2010 this is expected to decrease. All major global funding markets remained opened to the majors (principally Australia, US and Japan) as they issued debt supported by the Australian Government guarantee, which added 70 basis points to wholesale funding costs.

	Term funding issued (\$ billion)
ANZ	25.8
CBA*	10.5
NAB	32.3
WBC	45.0

*Reported issuances post 1 July 2009, as issuances during 2009 were not reported



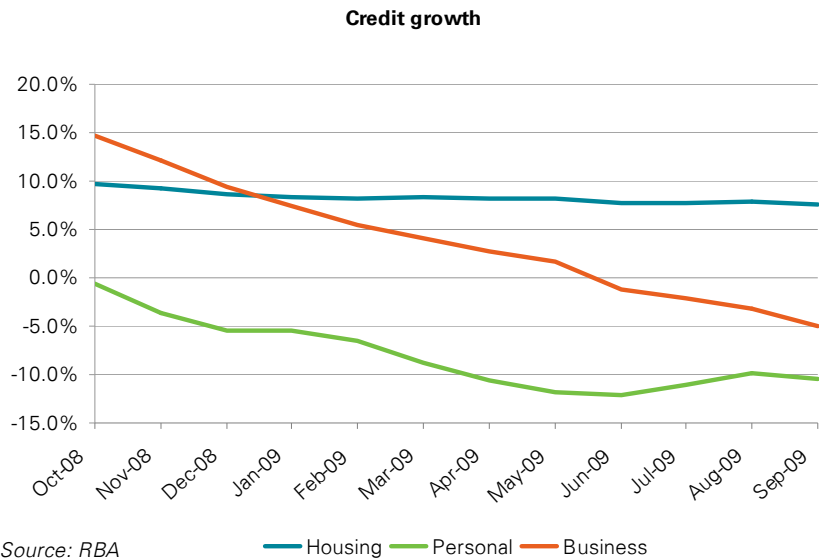
Assets

Total assets increased in 2009 by 6.3 percent to \$2,341 billion, compared to \$2,202 billion in 2008.

An increase of 9 percent in lending assets was driven by:

- Significant increases in housing loans in Australia of \$128 billion including the acquisition of BankWest by CBA (\$59.8 billion) and the impacts of the Australian first home owner grants from Federal and State Governments
- Offsetting the increase in housing loans has been a decline in other term lending
- After significant increases in derivative balances between September 2008 and March 2009, decreased volatility in foreign exchange, interest rates and credit spreads has seen derivative balances decrease in the second half of the year. Derivative balances of \$133 billion at September 2009 is comparable with \$126 billion at September 2008.

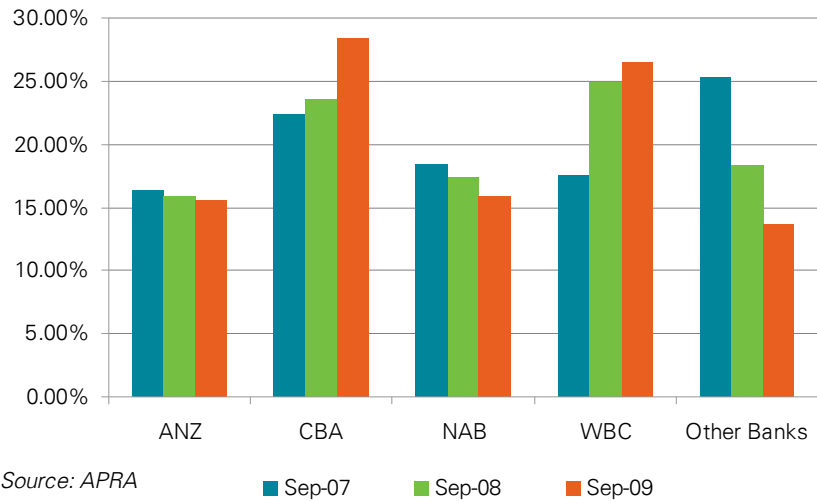
System lending growth since October 2007 is shown below.



Consumer portfolio

Consumer lending¹¹, which includes housing, credit card and personal loans, grew by 15.0 percent in 2009 for the majors, down from 21.3 percent growth recorded in 2008. Housing system credit growth was 7.5 percent as at September 2009, down from 10.0 percent as at September 2008.

Market share of bank lending to Australian households



CBA has increased its portfolio due to its acquisition of BankWest, contributing \$35 billion in home lending assets. Excluding the impact of BankWest, the growth in the consumer sector is 11.0 percent for 2009.

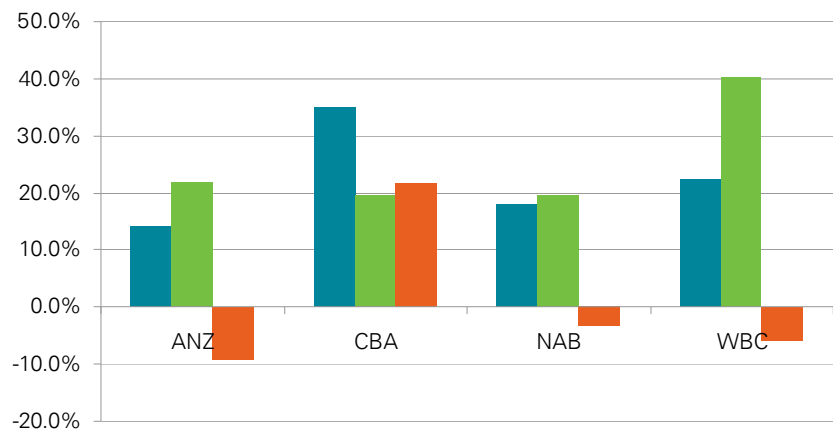
Market share of bank lending to Australian households¹² for the majors has increased to 86 percent as at September 2009 (September 2008: 82 percent).



Business portfolio

Business lending increased by 0.4 percent in 2009, down from 24.1 percent growth in 2008. The 2009 business portfolio of the majors represents a slowdown of corporate lending during the financial crisis driven by the banks' capital and funding constraints, credit issues within the market and falling system credit growth.

Growth in business sector



Source: KPMG

■ Sep-07 ■ Sep-08 ■ Sep-09



Global outlook

Conditions in the global financial services industry have improved considerably since March 2009. However, significant challenges remain despite the efforts of governments and central banks:

Economic environment - The market dislocation that began in 2007 has evolved into a global financial crisis with a knock-on effect on the real economy. This has resulted in a recessionary environment in most parts of the world with a consequent impact of a contraction in GDP, accompanied by growing unemployment, rising corporate failures and a fall in residential and commercial property prices. 2009 also witnessed an environment where governments as well as banks have been operating in a post nationalisation/consolidation phase. We expect that the worst of the credit crisis is behind us. There are signs of improving conditions and evidence of stabilisation in the world economy. Growth in Asian countries, especially China's stellar growth performance and recent results from Wall Street banks, such as Goldman Sachs, JP Morgan and Citigroup were dramatically better than had been expected.

Fragile banking conditions – While the state of the economy is showing signs of recovery, there are lingering concerns related to the banking industry as well as the economy. There are persistent problems that need to be resolved by governments and regulatory bodies internationally before shifting the strategy to growth. In fact, several factors point to continued weakness. Continued asset-quality troubles are expected to force many banks to record substantial additional provisions for the remainder of 2009 and 2010, as loan losses associated with on-balance sheet lending are yet to fully work their way through the system. This will be a drag on the profitability of many banks for extended periods and will further add stress to their capital levels. Commercial property continues to be an area of concern in many countries and transitioning exit strategies from emergency support measures still needs to be managed. Strong, sustainable global economic growth will only occur once these issues are addressed.

Capital, balance sheet, size and liquidity - In terms of capital, all banks are in the process of adjusting to what is now regarded as 'appropriate' capital. Balance sheets are also reducing in size although, to date, this seems primarily driven by a reduction in derivative balances and foreign exchange impacts rather than substantial reductions in advances or divestments. Whilst liquidity has improved marginally, it still continues to be a cause of concern. Financial institutions will continue to deleverage, build liquidity and create and preserve capital. The risk to capital from further write-downs on account of falling asset values and worsening credit outlook looks less likely due to improved trading revenues from increased volatility, higher volumes and wider spreads. The real test for the banking industry will be to manage the difficult

balancing act between increasing lending to creditworthy clients and preserving capital.

Profitability - The competitive market for savings and the increased cost of wholesale funding have negatively impacted banks' results. These increased costs have been offset by asset re-pricing as credit and liquidity risk is properly priced into products. We would expect the positive effect of asset re-pricing to continue. There is real confidence that the overall margins will improve over the next 2 years as central bank base rates rise and the cost of wholesale funding stabilises.

Markets businesses - A strong feature of many recent results announcements is the improved performance of markets businesses. Trading flow businesses generally (e.g. foreign exchange, fixed income) are benefiting from increased volumes and spreads. Credit markets write-downs are much reduced. It is reasonable to expect such performance may not be sustained.

Impairments - Real estate provisions for many banks in the UK, Europe and the US reflect the indications and suggestions that commercial property values (i.e. property developers, commercial property, house builders) still have further to fall, although predictions about the direction of property prices is very difficult to forecast with any degree of accuracy. In addition, there is still a rising trend in unsecured impairments, fuelled by increasing unemployment and decreasing house prices. It is expected that the level of unsecured impairments will not peak until 2010 or beyond in many countries. Increasing loan losses on commercial real estate are expected to cause more bank failures in the next few years, particularly in the US.

The housing market - Due to extremely low transaction volumes, it is difficult to know whether prices have flattened or not, leading to divergent predictions. In any case, house prices will be a key driver of mortgage provisions. In previous recessions, many householders were able to work through the negative equity of their properties provided they remained employed. Unemployment, therefore, will be the single most important fact in determining provisions. In addition, low interest rates have undoubtedly helped many borrowers cope despite falling incomes caused by the reduction in overall trading activity. This benefit will reduce going forward as more borrowers revert either to standard variable rates or to higher, fixed rate mortgages. Overall, mortgage provisions will be a key uncertainty for banks for the foreseeable future.

Political reform - Over the past 12 months, we have seen – across the US, UK and Europe – that many banks have been surprised by the severity of the measures imposed by government and regulatory bodies. As an example, it seems that the European Commission expects some real and consequential pain to be felt by shareholders (through divestments or otherwise) in order to maintain the penalties for requiring state aid and to maintain wider competition. The business case and business model for future success without government assistance has yet to be agreed. This remains a major area of uncertainty for those banks that are currently relying on government aid.

Government support – Governments will have direct or indirect control of a major portion of the banking sector for the immediate future. Banks under government influence will be asked to deliver against a wider array of objectives than merely enhancing shareholder value. Their bonus and, more broadly, remuneration policies will be in the public domain. Their approach to commercial lending will be under scrutiny and their pricing to customers in all categories will be challenged. Risk modelling will be more transparent. Unwinding the government support to the sector will represent a major area of focus for the management of banks and for governments.

Heightened regulatory scrutiny – Global regulation is to be developed for banking. Governments, central banks and regulators globally, are proactively addressing the economic crisis, with outcomes ranging from increasing capital requirements on banks that present greater risks to the system, protecting consumers and helping them make better choices, to strengthening the framework to deal with system-wide risks, all high on the agenda. In light of this, it is clear that the future levels of capital will be higher, the level of regulatory involvement in all banking activity will be more onerous and non-executive directors face greater expectations and a more challenging role. The impact of this regulation upon recovery in asset growth and profitability is hard to predict.

Accounting standards - International Financial Reporting Standards did not cause the financial crisis. However, the crisis has tested the standards – with criticisms of pro-cyclicality and undue complexity and a questioning of the appropriateness of including gains in the income statement for deterioration in an entity's own credit risk – and there is momentum for change. In addition, it has been the intention of the IASB for some time to fundamentally rewrite IAS39. Proposals on classification and measurement were issued in July and consultation is ongoing on impairment. Hedge accounting is to follow.

Australian outlook

Throughout the turmoil in the global financial system, the major Australian banks continue to shine on the international stage. They continue to report solid profits, are well managed, adequately capitalised and have maintained the benefits of high credit ratings. Against this backdrop, the outlook for 2009-10 financial year still remains difficult to forecast, however, the following factors will influence their performance:

Economic recovery – Having avoided a technical recession, the Australian economy has weathered the global financial crisis better than most national economies. Although there is a growing consensus on the positive economic outlook, the Australian banks remain cautious, with consumer and business confidence remaining relatively fragile. Home loan growth has stabilised, the slow down in business growth is continuing and personal loans growth is likely to remain under pressure in 2009-10. Against this backdrop, major Australian banks are well positioned to further strengthen their market position across many product categories.

Funding – While the major Australian banks all enjoy AA credit ratings (Standard & Poor's), funding will continue to be a focus. We expect funding conditions to remain difficult over the next year, leading to the continuation of credit rationing by the majors. We expect the emphasis for funding will continue to shift from the availability of funding (albeit this should not be taken for granted) to the pricing of the available funds. We also anticipate the banks to continue their vigorous competition for deposit funding (in order to reduce their dependence on offshore wholesale funding). We also expect the majors to look to offshore markets without calling on the government guarantee scheme. In summary, there is little doubt that the cost of funds will not return to pre-crisis levels due to a combination of elevated competition for deposits and increased pricing for risk.

Capital management – The major banks have raised more than \$20 billion in new capital through the equity and debt markets in the past year to boost their capital ratios. Unlike their international counterparts, they have been able to raise capital through shareholders and not via direct government contributions. The banks will continue to look for opportunities to raise capital to fund their business through institutional placements, other initiatives such as Dividend Reinvestment Plan (DRP) underwriting and through a sensible mix of funding across different maturity profiles, geographies and investors. While Australian banks are better placed and better regulated than their offshore peers, some analysts argue that 9.5 percent will be the new benchmark for tier 1 capital ratios. Finally, banks will also continue their efforts to reduce risk-weighted assets through optimisation of their portfolios.

Bad debts – Due to record-low interest rates, massive government stimulus support and a robust employment market, Australian consumers have largely continued to repay loans and borrow. If the economic recovery continues on this trajectory, bad debt levels are not expected to rise significantly further. Notwithstanding, there are areas of concern that persist to trouble the banks. Defaults on home loans and credit cards are expected to rise in 2009-10 when unemployment is expected to peak and interest rates rise. In particular, housing loans remain an issue in areas such as South East Queensland and New South Wales. Similarly, conditions in the commercial property market have continued to weaken, and as a result, there has been a tightening in overall lending standards. The banks will continue to invest in improving their credit risk management policies, practices and processes.

Competition – Since the onset of the global financial crisis, the Australian banks have been able to strengthen their competitive positions, particularly in home loans and deposits where they have grown their market shares at the expense of smaller banks. Further to that, each of the majors have announced substantial acquisitions during this period, domestically (in banking and wealth management) and regionally. Locally, the Australian Competition and Consumer Commission has expressed concerns over what they see as diminished levels of competition in the industry, hence any future banking acquisitions will likely face significant opposition. We expect that there might be further consolidation and acquisition activity with the regional banks, building societies and credit unions, as well as in Asia.

There were fears that many foreign lenders would repatriate capital to their home markets, further diminishing the levels of competition in the market. While this did occur selectively, foreign banks were reported to have generated strong profits in the second half and continue to participate in syndicated loans to major companies. As foreign players re-focus on the Australian marketplace (with improving positions in their home markets), we expect competition with the major banks in the business, corporate and institutional segments to increase.

Regulation – Additional regulatory challenges are on the horizon for all ADIs, including the banks in the form of new liquidity standards and the new National Consumer Credit legislation. Both of these will add to the regulatory burden and need to be factored in to strategy considerations and analysis of cost structures going forward in order to efficiently comply and more importantly, drive the desired customer experience.

Cost reduction – In the face of a slowing credit environment, we expect the majors to continue their focus on cost reduction, as well as driving improvements in productivity. Over the medium to long term, they will be seeking to reap scale and process efficiency benefits (amongst others) through the successful integration of recent acquisitions and/or systems and technology upgrades.

End notes

- ¹ CBA result for year to 30 June.
- ² Profit represents statutory profit attributable to shareholders of the company, except for WBC which is on a Proforma basis.
- ³ Excludes impairment expense arising from available for sale investments (CBA: 2009 \$365 million; ANZ: 2009 \$20 million, 2008 \$98 million).
- ⁴ For NAB, reported net provision for doubtful debts has been used to calculate the ratio of collective provisions to credit risk-weighted assets.
- ⁵ Source: Bloomberg as at 30 September 2009.
- ⁶ Lending portfolio comprises gross loans and advances (excludes acceptances).
- ⁷ Wealth management profits are on a cash earnings basis as reported by the banks, except for ANZ which includes ANZ's share of ING net profit.
- ⁸ KPMG's "UK Banks: Performance Benchmarking Survey", Half Year 2009
- ⁹ Return on Equity is as reported in the individual banks' profit announcement on a cash basis. ANZ's reported 2008 and 2009 Return on Equity has been recalculated based on cash earnings disclosed in 2009.
- ¹⁰ Source: APRA, *Monthly Banking Statistics*, September 2009, Table 4. Percentages quoted exclude building societies and credit unions.
- ¹¹ Consumer lending includes housing, credit card and personal loans (when separately disclosed). The balance of total lending is assumed to be business lending.
- ¹² Source: APRA, *Monthly Banking Statistics*, September 2009, Table 2.

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