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Transcript ANZ 3Q20 Trading Update

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Yours faithfully

Simon Pordage
Company Secretary
Australia and New Zealand Banking Group Limited

TRANSCRIPTION

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[START OF TRANSCRIPT]

Jill Campbell: Thanks operator and good morning everybody. It's Jill Campbell here I'm Head of Investor Relations for ANZ, for those of you I haven't met. Welcome to the conference call and audiocast for our 3Q20 trading update. This will be available also for replay later in the day. We've released a number of materials today, including two slide packs which were released as one document. For the purposes of the session this morning, it's the discussion pack that we'll be referring to, we won't be taking you through the pack, but it will be helpful if you've got that handy.

I also apologise if at any point there's a little less clarity in the sound than we'd like, we're in a Stage 4 lockdown in Melbourne and so we're working through all of the logistics issues that come with that.

We haven't done a Trading Update for a while, in fact not since 2017 and so a reminder about how this will work. Our CEO, Shayne Elliott and CFO, Michelle Jablko, will speak for between 5 and 10 minutes. We'll then go to Q&A. The operator has already explained to you some instructions about how to do that, but I'll come back with a little bit more housekeeping before we start.

Also in the room with us today, we have our CRO, Kevin Corbally, and on the phone, the head of our Australian Retail & Commercial business, Mark Hand. I'll hand over to Shayne.

Shayne Elliott: Thanks Jill and thank you all for joining us this morning. Now as Jill said, this will mainly be an opportunity for you to ask questions, however I do want to make a few initial comments and then I'll ask Michelle to provide a couple of observations. Firstly, it's very clearly a difficult and unusual time and our thoughts are with those that have been impacted either from a health or a financial perspective. I want our customers to know that we will continue to do all that we can to support them through to the other side of the pandemic.

You only need to look around the streets of Melbourne to understand the impact of COVID, not only on the way we go about our daily lives, but also on the economy more broadly. Even in New Zealand, a country that on every measure had this virus beat, recent days demonstrate this virus is going to be with us for some time to come. As a community, as an industry and as a bank, we need to adapt to a COVID way of life.

Governments will continue to manage the health and macroeconomic response and it will be up to the banks, like the ANZ, to support customers while balancing the interests of our shareholders, as well as the safety and wellbeing of our employees. I don't want to sound overly pessimistic or unrealistic. Sure, Victoria is doing it tougher than other states at the moment, but Western Australia is ticking along with iron ore prices holding up. Parts of Queensland not exposed to tourism are already showing signs of recovery, particularly in the agricultural sector and even in Victoria, there are businesses and sectors of the economy that have adapted and are doing okay.

This is going to be a very difficult environment to navigate. It's fast-changing and the impact varies from state to state, industry to industry and customer to customer. It requires us to have the capacity, flexibility and the experience to make decisions and manage that change in real time and I'm pleased to say that to date, we've navigated this difficult environment effectively. As a bank, we entered the crisis in great shape, with an incredibly strong balance sheet, with record levels of capital and liquidity.

The work done over several years to simplify the Bank means we're now only focused on the things that matter, our people are more engaged than ever and we are able to quickly adapt to the challenges the future holds.

Put simply, we've never been in better shape to support all our stakeholders through what will be one of history's great challenges. But it's not just luck, it's a combination of decisions that we've made over many years to focus on the things we're good at, strengthen our foundations and invest for the long term.

There is no doubt we're also benefiting from a strong regulatory regime and swift and decisive government intervention. You'll see from the Media Release and the Chart Pack that we posted an unaudited Statutory Profit for the third quarter of $1.3 billion and a Cash Profit of $1.5 billion. Common Equity Tier 1 capital is strong at 11.3% on a pro forma basis, without having to raise additional capital from shareholders. This is a good result in difficult circumstances. Our operational and balance sheet strength allowed us to provide significant support to customers and our people, while also providing a fair return to shareholders.

Now it's worth noting that not all banks have the same exposures. Sadly, the Small Business and Commercial Property segments are where much of the economic pain is currently being felt. Relative to others, our loans to these segments are much smaller. But despite that, we took the prudent step of adding to our credit reserves in the quarter.

Our performance and strong balance sheet position developed the confidence in our ability to navigate this crisis and it's meant we've been able to announce an interim dividend of $0.25 per share fully franked. As you know, we delayed this decision from April, however we believe it was in the long-term interests of the Bank and its owners that we waited until we had more information and given all that has happened in the last month, this has proven to be prudent.

Turning to the underlying business, during the quarter we outperformed in Australian home lending, growing well above system. Customers acted very prudently by strongly increasing their savings and paying down credit card debt. Institutional customers also acted prudently and repaid loans in the quarter, particularly in our international franchise, which delivered a capital benefit to the Group.

Markets activity was also higher as customers sought to increase currency and rate digits and as a result of strong customer flows and underlying volatility, our markets business revenue was up 60% on the first half quarterly average.

In fact, as the impacts of the health crisis became better understood, the performance of our Institutional and international business highlighted the benefit of maintaining a diverse and well-managed portfolio of businesses. We have taken the foot off the accelerator when it comes to simplifying our business, with the sale of UDC in New Zealand to Shinsei Bank and our offsite ATM fleet in Australia to Armaguard.

Costs were down 1% for the quarter (compared to the first half quarterly average). This is a very pleasing outcome, which is a result of thoughtful and disciplined cost management in the environment. It wasn't a kneejerk response to COVID or from underinvestment. In fact, we invested record amounts this quarter to build a better bank for customers and staff. Despite this, we expect annual costs to remain broadly flat on a FX-adjusted basis for the year.

The biggest feature we'll call out, however, has been the work we've done to support customers through the pandemic.

In many respects, you have to remember this crisis is only five months old. It seems an eternity ago that we were all free to go about our business, or here in Melbourne, even venture outside our suburbs. I don't know what the future holds, nobody does, but what I do know is that we are better placed than when we entered the GFC to identify changes and quickly adapt. We've made prudent investments in big data and real-time monitoring systems, that allow us to spot trends quickly and respond to customer needs promptly. But I also know that our people have stepped up and it's been our company's purpose of shaping the world where people and communities thrive that has guided this response.

Great companies step up when it really counts and while challenges clearly still remain, we've already supported around 200,000 customers in Australia and New Zealand with their loans, which will go a long way to carrying people to the other side of the crisis. Finally, while this is an investor briefing, I would like to acknowledge the terrific work of our 40,000 people across the world.

From our hubs in Bangalore and Manila, through to our contact centres in Australia and branches in New Zealand, they've all done a great job for customers in very difficult circumstances, with people productively working from home despite competing priorities for a long period. They've also done their best in keeping costs under control, with everybody playing their part in managing our annual leave balance. This has been a meaningful contribution to our cost work and I thank them all for their efforts.

I'd also like to acknowledge the passing of our former chief executive, Will Bailey, last week. Will was chief executive between 1984 and 1992, having started as a teller in the Oakleigh branch at the old ES&A Bank in 1950. I did have the pleasure of meeting Will, but I never worked with him. But I know he was a mentor to many of ANZ's leaders and made significant contribution in building the ANZ we all know today over many years, particularly in his efforts to modernise the Bank through the use of technology. On behalf of everyone at ANZ, I'd like to pass on our condolences to his wife, Dorothy and his daughters Alison, Robyn and Merryn as well as his extended family and friends.

With that, I'll now pass to Michelle to make a few comments before opening up for questions. Michelle.

Michelle Jablko: Thanks Shayne. I'll just make a few comments, with a focus on how we've strengthened our balance sheet and capital over the quarter. If you've got it handy, I'd point out slide 2 of the investor discussion pack that we released today.

You will see here we finished the June quarter with pro forma CET1 of 11.3%, which is around $50 billion of CET1 capital in dollar terms. This means in a pro forma sense we were able to generate 47 basis points of capital over the quarter, which is equivalent to a $2.1 billion capital raising without shareholder dilution. Let me take you through how we did this.

Firstly, pre-provision profit added 43 basis points and was up 6% for the quarter. We haven't provided granular detail on this, but I'll point out that Institutional benefited from geographic diversification and our markets business achieved revenue around 60% higher than the average of the two quarters. Margins were impacted by low rates, as we foreshadowed at the first half and also higher liquids and mix related impacts.

We manage costs really well. Absolute costs were down 1% compared to the average of the first two quarters. We diverted resources to where they were most needed in response to COVID and we continue to benefit from productivity across the Bank, as well as savings like lower travel costs. We were able to manage costs down, even though we invested more in our business this quarter than we ever have, so we were able to benefit from our ongoing focus on simplification, which drove productivity in the quarter, plus we took tactical action, but not at the expense of good customer outcomes or business investment.

Now while we grew PBP, we didn't consume additional risk weighted assets in doing so. In fact, we released 12 basis points of capital on an underlying basis. This is consistent with what we told you at the first half result. You might remember we said we supported customers with liquidity in the early stages of the crisis and we told you this was largely timing. Since then, many of our customers have not needed this level of liquidity, which has released capital. Most of this was in our international business and we've seen this trend continue in July.

In terms of credit impact, this was 21 basis points for the quarter, split roughly 50/50 between the increase in credit provisions and risk weight migration. We increased our collective provision by $234 billion to $4.65 billion. If you recall, at 31 March we based our EPL modelling on some very grim economic forecasts, including a 13% peak quarterly fall in GDP and 13% peak unemployment in the June quarter.

While more recent economic forecasts have not be as negative as that, we increased our collective provisions. We believe this was appropriate given the level of economic uncertainty, so for example, we added further overlays for small business and mortgage deferral.

Our risk weight migration today has been less than we originally anticipated, especially in our Institutional portfolio and we're very well progressed on all our wholesale customer reviews. We thought migration might have been closer to 20 to 25 basis points this quarter, instead of the 10 basis points we actually experienced.

A key reason for this is that our customers have been proactively managing their own balance sheets, they've been managing their own costs and some have also raised capital. It's too early to call out whether this means our risk weight migration to the end of 2021 could be lower than the 110 basis points we previously said with our base case. We'll provide much more detail at the full year and of course consider the economic outlook again at that time.

We've had strong capital generation this quarter, even after credit impacts and then of course we've announced the sale of UDC, which is on track to complete in the coming weeks. All of this has given our Board the confidence to pay a prudent first half dividend of $0.25 per share, fully franked and without a discount on the DRP. The dividend is 46% of first half statutory earnings, but 30% of earnings if you add back in impairments we took at the first half of AmBank and Panin which were capital neutral.

We think this decision is sensible right now. We know we have shareholders that depend on us for part of their incomes and we've balanced this with keeping our capital position strong and not [unclear] shareholders. It also sits comfortably within the APRA guidance.

I'm now going to hand back to Jill for questions. I'll point out, we've got quite a bit of information in the slide pack on our customer support packages, so of course we're happy to talk to any questions.

Jill Campbell: Thanks Michelle and thanks Shayne, I'll hand back to the operator in a second. As I mentioned, we have our CRO, Kevin Corbally with us today and Mark Hand who is our Group Executive for Australia Retail and Commercial is also available. If you can please just try to limit your questions to two, the IR team are available after this call to help you with any additional questions that we don't get to. To any media dialling in, thanks so much for participating and welcome, but if you could please direct your questions to the media team. With that, I'll hand back to you, operator, to start the questions.

Operator: Thank you. If you would like to ask a question, please press star then one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star then two. If you are on a speakerphone, please pick up the handset to ask your question. Our first question is from Richard Wiles of Morgan Stanley. Please go ahead.

Richard Wiles: Good morning. Could you provide some more commentary on net interest income, particularly the impact of liquids on average interest earning assets and the margin, the impact of competition and whether the strong markets income meant the underlying decline in margin was different from the headline decline please?

Shayne Elliott: Thanks Richard. I think it's best that Michelle take you through the numbers. Michelle.

Michelle Jablko: In relation to liquids, that had about a two basis point impact on margin. I think we increased liquids by about $13 billion for the quarter. In terms of your question on the difference between the underlying and the headline its one basis point.

There was some other ups and downs. We've called out the main ones, which were really low rates, which was six basis points as we'd previously told you, liquids as I've mentioned, and then mix. On mix, the main things were a shift from variable to fixed home loans which has gone up a bit this quarter and also just we had more Institutional relative to the rest.

Richard Wiles: Thanks, Michelle. Could you also comment on competition?

Michelle Jablko: Yes. In terms of competition, I'd say the impact of competition was broadly the same as its always been, but we had some offsets to that. Because if you recall, we had some high Institutional lending margins through the quarter. So I would say in terms of competition, similar to the trend First Half

Richard Wiles: Okay, and if I could just ask a second question, please. Do you have some sense about what proportion of your deferred home loan customers and deferred small business customers may seek an extension of that deferral for an extra four months?

Shayne Elliott: I mean the short answer to that, Richard, is no we don't actually. I think it's just a timing issue. We're right at the point actually where we're going to start

to know. We've obviously been in contact with all of our customers. But I might just ask Kevin. Do you just want to talk where we are in terms of that contact program and when we will have better insight into the numbers that will be seeking the extension, or any colour you can give Richard on that?

Kevin Corbally: Sure. Look, at the moment we're contacting every - but I think home loans first. We're contacting every deferral customer either digitally or, alternatively, via phone or letter as the case might be. That's to ensure they understand when those payments are actually due to restart and what the payment will be and what their options are. We've also given them the opportunity, and some have done so, to schedule a discussion closer to the end date. Or alternatively, they can speak to someone sooner if they need to.

What we're doing in terms of the process, from a call-in perspective (telephone perspective), is we're actually checking in on those portions of the deferral group who have the characteristics, if I can describe it that way, that suggest they might need some more help - they're possibly higher risk, e.g. they've had a material drop in their income or they're unemployed.

What we have seen, which is really interesting, is that two-thirds of the customers who sought the deferral, actually their income level has either improved or it's stable. In addition, a quarter of the customers who sought deferral have also made a repayment. Notwithstanding the fact that they were actually on a deferral during this period, they still continued to make a repayment. More than half have at least three months or better in terms of payment buffer.

So that's essentially the process. At this stage, we've contacted in the order of about two-thirds of our customers on the mortgage side. On the commercial side and the small business side, slightly different in that you have to opt into that process. We spoke with every customer prior to them actually taking up the package, so they understood exactly what it was that was on offer.

We're not required to do the same three-month reviews as we are for mortgages. However, we have started contacting those customers in any case and we have continued the normal credit and portfolio monitoring that we would have as well.

Within the Small Business and Business Bank, some of what we've seen there is that 60% of them have actually, interestingly, got higher cash balances than at the same time last year, and for 45% of them, their cash inflow is actually greater than the same time as last year.

One of the key things commercial customers have been trying to do is figure out how they can reduce their cost base. About a third of them have actually decreased their cost base by more than 30% which is quite significant. So that's where we're up to.

Shayne Elliott: The other thing I would add to that, Richard, just to give you a bit of colour clarity on that, over two-thirds of the home loan customers where Kevin mentioned where their income is stable, that's quite a broad definition. So that might still be down, it might be down 10%, 15%, but it's not fallen off a cliff. So just to be clear on that, it doesn't mean it's necessarily flat.

The other thing I would just add there, I made a reference in my opening about the data investments we've had. That has really shone through. Compared to the GFC, our ability to actually, literally in real time, going through, getting all the customers who've got a Jobseeker payment in their account, getting all the customers who have seen their income levels fall, and our ability to be able to respond and target, is just at a massively different level than it was in the past. I think that's enabled us to be much more targeted in the way that we respond and reach out. It's not perfect because we don't have everybody's operating account, but it's really been a massive advantage I think this time.

Operator: Our next question is from Ed Henning of CLSA. Please go ahead.

Ed Henning: Thanks for taking my questions. Just two questions from me. You talked about the trends continuing in July around the pay down of the Institutional borrowers. Can you just run through how much more you think has got to play out here? Could the fourth quarter be the same as the third-quarter impact, or you think this is falling?

Shayne Elliott: That's a really good question. Obviously, we don't know yet. But, look, let's just back up a little bit here. What happened at the end of the first half, March, right in the heat of the moment, COVID really heavily hit the shores not only

of Australia but the United States and parts of Europe. That's where a lot of our multinational customers are based.

What did they do? They did what they're supposed to do. They shored up their balance sheets, they hoarded cash, they drew down liquidity, etc. We saw that more than others and we made sure we were getting paid for that. So people were basically behaving as you'd expect.

In the third quarter, things started calmed down, capital markets continued to operate. People realised they could raise equity, and we saw that on a massive scale here in Australia, in particular, and also internationally. Treasury, generally, calmed down and realised - I don't need this expensive debt - and they started repaying.

So we stayed at a reasonable clip in the third quarter. If we look at the period between 30 June and today that trend has continued at about the same pace. So even today it's lower. I don't know from here. I think it really depends on the state of capital markets and the general economic sense. But if you were a betting person you'd have to say it's probably a worst case of flat and probably continue to come down.

Which from our perspective isn't a bad thing really, it releases capital. But we'll continue to support our customers as necessary. But I'd say it's probably flat to down would be a pretty decent estimate.

Ed Henning: Thanks. Just the second one. Markets income was obviously very strong during the period. Can you just touch on what's happened in July and August now you've seeing that going forward?

Shayne Elliott: So let's get back to why it's strong, it's coming from a couple of things. Again, our markets business, I think it's worth pointing out, is quite different to some of our local peers in particular. More than half of our markets business is international. It's not in Australia. In fact, some of our biggest operations are in Asia, for example, in Singapore, and also in London and New York. That goes for that international franchise we had.

Actually, there has been – the really strong performer has been offshore. It's been strong everywhere, but out performance has really very much been in our international franchise, and for the reasons that I mentioned. Underlying volatility, what happens? Well, there's a bit of spread, a little bit on volatility.

You get a little bit more activity from customers who are seeking to hedge. All of those conditions have continued from the third quarter into the fourth quarter. So the basic conditions persisted, but probably not to the same degree. It's not as volatile as it was. Spreads are not as wide as they were. But it's still a pretty buoyant environment for global markets businesses.

Again, just to be clear, our business, what do we do in markets as opposed to others? Our franchise is a very big foreign exchange franchise and a rates and credit franchise. Our commodities business is tiny, we don't do equities, etc. So it continued probably at a slightly more modest pace though, but still looking pretty good.

Ed Henning: Okay, thank you.

Operator: Our next question is from Andrew Lyons of Goldman Sachs. Please go ahead.

Andrew Lyons: Thanks and good morning. Just a question on slide 11, just around your business loan deferrals. On slide 11, you note 94% of your SME book on deferral is fully or partially secured. Can you perhaps provide a bit more detail about what this collateral is, and how you'll ultimately balance the needs of your customers versus the needs of your shareholders as we go deeper into this cycle and you may have to start accessing that collateral in a fairly significant way?

Shayne Elliott: Yes, look, I'll start with that, Andrew, and I'll ask Kevin to give a bit more detail on that. Starting at a little bit high level, but philosophically what we're saying here, for the most part the reason that these small businesses have gotten themselves in harm's way is through no fault of their own. It's not that they had bad business models, it wasn't that they were over geared, it wasn't that they made bad decisions.

They have been caught in a general - their business was essentially prohibited by government. So the good thing is fundamentally good businesses can, in the right circumstances, quickly get back on their feet.

Now, those circumstances, unfortunately, are outside of their control. They're largely due to government policy. So we take the view that the best thing we can do here, the best people to run those businesses, whether it's a

manufacturing business or a restaurant or whatever it might be, are the people who currently do.

So giving them time is the right thing to do. So that's the approach we've taken. We are very fortunate, the cost of giving them time is a hell of a lot lower than it would have been in the GFC or in any other normal financial crisis. So the cost to them and cost to us of giving time is lower.

But we know, sadly, that even if tomorrow morning a vaccine is discovered and governments open up everything, not all of those businesses will have the wherewithal to get back on their feet, you're quite right. Sadly, at the right time, we're going to have to take some hard decisions. That's what we do or that's our role in the economy. But again, I think we've taken that view that the best thing to do is to give as much time as we can. It's in their interests and it's actually in our interest that these people get back on their feet.

So I think we are being more tolerant in terms of - and really focus on that customer care in terms of that balance. The cost to the shareholder is actually quite low of giving that time. That's got to be a really, really important factor when you're doing this. So this idea of a cliff that in some magic state when all these things happen we're going to act irresponsibly I don't think holds water for all sorts of reasons.

Kevin, do you want to add anything, it is true there's a lot of security behind there.

Kevin Corbally: Typically it is secured by either residential or commercial property. There are some other assets that businesses have as well but the vast bulk of these is that. When you look at the security for SBB typically it is over 100% secured and partially secured is a bit less than 100% but it is predominantly residential and commercial property.

Shayne Elliott: But obviously we've run models and our analysis considers what if the bad things happen to large chunks of that? What is the dimensions of that?

The good thing - and the bad thing about it, obviously, is that you really have to make some pretty difficult decisions and you might argue well, a lot of that security is the same category. On the other hand is, it tended to be pretty well diversified and so…

Kevin Corbally: On that point, Shayne, you're absolutely right. When we -determine the risk rating on a customer, we actually run sensitivities on the value of that property. So the property data is sensitised so- we have very different scenarios and those scenarios will drive an outcome in terms of the risk or security rating that we then provide to the customer.

Andrew Lyons Thanks so much.

Operator: Thank you. Our next question comes from Jonathan Mott of UBS. Please go ahead.

Jonathan Mott: Thank you, I've got a question on a dividend. Really, why did you see the urgency to pay it now? It seems very unusual to have a delayed or belated dividend. Why didn't you wait until the full year result in three months' time when the economic outlook is going to be a lot clearer?

Especially when you haven't seen the full impact of procyclicality, you haven't seen the deterioration going through and if you look across Victoria and Auckland, you've got 10 million of the 30 million people in Australasia locked in their houses at the moment. Why not wait and see how the economy is going, rather than pay a dividend out on a belated basis?

Shayne Elliott: Yes, fair question. Just to put it into context, Jonathan. We generated pre provisions 68 basis points of capital during the quarter and what do we do? We used around a third of that for credit costs, provisioning etc. and the dividend we paid out is 15 basis points of that capital we paid out and that's why we used the word modest.

We've got a really strong capital position. Could we have retained it so we were even higher? Yes, well of course. I mean - and there will always be - this is a judgment.

The judgment that our Board took was, this is about balance. Our business is profitable. It generates profits every day. Not as much as it used to but it's still profitable and that's generating organic capital during the quarter. You saw that in this quarter and you'll continue to see that.

That allowed us to put away some more money for a rainy day and increase our credit provision again. Yes, despite the fact that actually on some

measures, economic outlook is better today than it was at 31 March. At the half. But nonetheless, we're prudent and we've topped up our credit provision. We've strengthened our capital ratios again and we've been able to pay a modest dividend to shareholders.

We think that balance is the right thing to do. You can always kick the can further down the road and wait for more and more information but we think that was a fair thing to do. Then also, I think - look, we also have a role in the broader economy and we know that many of our shareholders are retirees and depend upon that income and that really weighted. We thought that it was a fair decision to make.

But again, I think the more - the most important point of all of that is let's put it in context. It's 15 basis points here. I think that on any description, it's prudent and modest.

Jonathan Mott: Okay, can I just ask a second question if I could? Probably to Kevin. You spat out a lot of positive statistics about the 12% of the mortgage book which is still on deferral, like a two-thirds haven't seen a fall in income. Can you give us - well we all know in banking it is tail risk. We're not worried about the two-thirds that haven't seen a fall in income, we're worried about the one-third that have.

Can you give us some statistics about the tail? How are they looking? What are they seeing in their income and what prospects have they got of getting back on their feet and repaying their debt?

Shayne Elliott: So I'll start, Jon and I think your observation is spot on and I - in my experience, that's even more the case in this crisis than it is in a normal one. The pain of this crisis has been felt disproportionately by a relatively small cohort.

The more impacted part of the economy has tended to be lower-skilled workers, more casual workers and sadly more females, more low-income cohort and therefore that's disproportionately the renter population as opposed to the homeowner population but nonetheless, you're right and there's a tail risk.

We do have some colour on that, Kevin can you talk to the proportion there. So for example, a number of people that are home at the moment are on

JobSeeker the proportion who actually aren't employed is small, as you can imagine. But do you want to give a bit of colour to that?

Kevin Corbally: Yes, look, a couple of things I'd say with one really important one, An important one to remember is that every customer who we offered a home loan deferral to had to be current with their loan - when the deferral was granted.

Each of the Banks has done this slightly differently. Not everyone used that approach in terms of who they granted the deferral to. We know we've been a little stricter than possibly some others. That's the approach we did take.

It's very difficult to see who is getting JobKeeper but we can see JobSeeker and that's a single digit percentage of those that are on deferrals.

Jonathan Mott: Just in terms of trying to compare that to comments from one of your peers, I think it was NAB came out and said they're seeing a disproportionate number of people who are in the private bank and had mortgages over $1 million on deferral. Are you seeing a very, very different cohort on deferral and having financial stress?

Shayne Elliott: Yes. I think - I don't - obviously, don't know their book as well as ours – but I imagine that some of that is to do with their business mix. Because a lot of small business people could be private bank customers we have not had that experience.

There is a slight skew to slightly bigger mortgages but that is on average slightly higher. That sort of makes sense because as you know, they're averages and in our total book, there's a whole bunch of people who have got a $50,000 mortgage, probably don't need to get a deferral but they're only small. So no, we don't have that same skew at all. We wouldn't - we wouldn't have identified that as a trend within our book.

Jonathan Mott Thank you.

Operator: Thank you. Your next question is from Brian Johnson of Jefferies. Please, go ahead.

Brian Johnson: Good morning and thank you very much for giving us the opportunity to ask some questions. I have two questions. The first one is the slide where you've got on your home lending, the growth. New sales, $10 billion, new sales ex.

re-fi $10b and then net of Refi $5b, then repay down $15b, which is telling us that the growth is basically the redraw and the interest.

The first question is, can you confirm that basically what has grown your book, how much of that $4 billion is the deferred interest that you - the interest that you've accrued on the deferred home loans?

The other point about it is - Shayne, is that I know that you're very positive that it's starting to turn around. Is that performance good enough? Then I have a second question, if I may.

Shayne Elliott: Yes, look I'll answer it. I'll get Mark Hand who is online to give you a bit more colour, Brian. Of the - so the technical answer to your question, of the $4 billion in redraw and interest, it's about 10% of that relates to the deferrals that you mentioned.

We had some issues a year ago with things like processing etc. We spent a lot of money - I've talked about record investments and part of that has been to get our home loan processing back into shape.

We had a big campaign a year ago, which was very, very successful (David Hasselhoff). That really gave us the ability to test some of our processes. So then, what we've been doing this year, actually just as COVID was starting, was we went out with a very, very sharp fixed rate offer in market.

I - we were stunned by the response. We - you might have thought that in a COVID time we would just sit on our hands. What we saw was a massive uplift, you know across the industry in terms of refi. So we were in the right place at the right time. We got completely smashed with volumes – good thing. Did mean our processing times blew out again. We saw levels of application at multiples of what we have seen in our history for an extended period of time which is a good thing. Those things are still being worked through.

You are not seeing the benefit of that volume yet because, as you know, there is a time delay between the funds are approved and drawing down. So in the third quarter numbers here, you're just starting to see some benefit but that will be something that will be much more evident in 2021.

We do absolutely think we are doing enough. The volumes have stayed relatively high. So higher than normal for us. We know we continue to pick up share. We've made a judgment to our pricing etc. to make sure that our - we're in the market getting a fair return for the risk.

We've been very targeted about the kinds of loans that we want because clearly, there's a heightened risk at the moment. But Mark Hand, you're much closer to it in terms of just giving Brian and the others a bit more colour on the home loan business.

Mark Hand: Yes, probably the only other thing to add is, in that repayment bucket, because of the COVID environment, we've seen significant deposit growth and that's included in off-set accounts, for instance. Customers that have a re-draw capability at their- I guess their mortgage, have paid against that mortgage, knowing that they can withdraw it and that is effectively their buffer. So that minus 15 number, I'd suggest is a little bit elevated.

Then, as Shayne said, this is up to 30 June where we saw really good volumes late last year, right through that period this year but a lot of those deals have hit the balance sheet you'll have seen from the APRA stats in the last couple of months and we expect to see that to continue.

Our re-finance out continues to improve so I wouldn't call it a flight to quality but there has been a significant flight to the major banks throughout this period. So where we expect to see continued growth and some of that repayment response because of COVID will ease.

Brian Johnson Thank you.

Brian Johnson: Yes, the second question, Shayne, when we have a look at it and you might recall, I complained rather loudly about what I thought was the relatively poor disclosure and I'd just like to reiterate that point. But on the loan losses - on the provisioning and the capital intensity.

But as far as I can work out today, you've lifted your provision coverage to exposure at default from basically 42 basis points to 45 basis points whereas your peers are all sitting at 60 basis points.

You've had a higher historical, basically rate of loan losses than your peers, and you acknowledge that in your expected loss disclosures.

We can also see that in your housing book, you have a much higher proportion of greater than 90% LVRs. Can we please get a little bit more detail on what you've done in changing the economic scenarios? What have you actually done in the provisioning and the probabilities that you've basically assigned to the base case and the undisclosed downside case?

Shayne Elliott: Yes and in a moment, I'll get Michelle to answer and Kevin to add to that but just going back a little bit before we get into detail. I think again, we have to go back to the fact that our businesses are very different. As you know and constantly criticise us for, we have a much bigger Institutional business than our peer group.

The reality is that today our Institutional book is 86% of Investment Grade. Try as we might, when you look through this crisis, at this stage - and I don't think we're alone, this does not appear to be a crisis that has done a disproportionate impact to the Institutional side of the business. As you know, the Institutional bank, just the normal course of business, has a much higher risk weight in the first place when you're booking business. It is very very different than a business that might be exposed to for example the SME sector which as you know we're not. So there are differences in this. Michelle, do you just want to talk through some of this …

Michelle Jablko: Sure.

Shayne Elliott: …and importantly the ECL function.

Michelle Jablko: Yes and we will provide additional information at the full year as well. The way we thought about it, if you go back to what we provided in March, my comments - we had a pretty grim view of the economic outlook at that point in time. We can debate the various assumptions around that but we had a pretty grim view of the economic outlook.

What we have done now is while the economic outlook is still negative, at the end of June it was less adverse, but what we did was increase the ECL. We did that through a few means.

Partly through changes in the probability weight and partly through overlays. Again, I am happy to provide much more detail at the full year with all the disclosures then taking on board your feedback, Brian.

Brian Johnson:	Sorry, the other question, Michelle, was on the capital density. Previously you said 110 and I can see in the slide there seems to be about - would I be right in thinking 10 of the 110 has happened in the quarter?
Michelle Jablko:	So, 10 in the quarter, we had seven in the second quarter as well, so 17 of the 110 has happened so far. What I did say is it's a bit early to predict this. What we are seeing – we are really well progressed in terms of our wholesale review, as of June, we were about half way through and today on institutional, for example, we're probably about two thirds of the way through and we're well progressed on Commercial as well. What we've actually seen in our customers, and clearly we don't do this once and set and forget. Our actual outcomes are tracking more positively than what we'd anticipated might have happened this quarter, but I don't want to call out yet a sensitivity to the 110...
Brian Johnson:	Michelle, your ECL provisioning that you say that you've changed the economic forecast and made them slightly more adverse, are they still more bullish or, sorry, less adverse than the RBA's August restated base case scenario.
Michelle Jablko:	Sorry, again, the way we have done it, I don't want to make it so formulaic we've got overlays, et cetera, in there. The way we did it is in our March forecast, which we disclosed, they were in some ways more adverse than the RBAs on slightly different, probably more adverse up front, but on a slightly different track in terms of how things improved, but broadly speaking about the same. What we have done today is despite the economic forecast being a bit better and clearly that changes all the time and we will update it in September, we have added to the provision and we have done that through a mix of, as I said, probability weights and overlays.
Brian Johnson	Thank you.
Operator:	Our next question is from Brendan Sproules of Citi. Please go ahead.
Brendan Sproules:	Good morning. I have a couple of questions. My first question is just on your operating expenses for the quarter. In the first half you actually called out three notable items in expenses. I was wondering if you could help us understand how much a change in those notable items has contributed to this quarter's result. Then I have a question on your provisioning as well.

Shayne Elliott: I'll give you the generic answer and then Michelle can talk. Brendan, really importantly what we have done through this is look, clearly COVID is overwhelming and there's a lot of things that we need to adapt to, but we have not given up on our long-term ambitions and our strategic desire to simplify the bank and make it more efficient. That will continue at pace. We have been more thoughtful about how we are implementing those changes because of the impact on people and just generally your ability to get stuff done working from home, but that does continue.

That transformation is just, a lot of it, is dividend to the business, it is just better productivity and a lower/flat cost. So that will just continue with a whole raft of detail in there and so the important thing is that the performance of the quarter was not a kneejerk reaction to COVID, let's go and hack out costs, , let's go tighten people or anything like that. We didn't do that at all.

What we did do is we quickly went back and looked at our cost base and said what are the things we can manage differently and more tightly. Obviously you get a tail wind or trade-off, I mean if you don’t do anything it probably just stops right. We continued in terms of our productivity work to get that cost down. The other thing I will mention is that this is not come because we've slowed down in business, so our investment in new technology, new platforms, new features and functions, actually increased in the quarter. It was the largest investment quarter we have ever had in our history. That's a good thing because those things will drive benefits, not only in productivity but better outcomes for customers in terms of some of the new platforms.

Because of COVID we brought forward some of that investment, for example, e-signatures, the ability to do things digitally that might have been features on our backlog. We brought those forward because they're more appropriate.

Michelle you want to talk through the large / notable bit …

Michelle Jablko: Yes, and Brendan when we talk about expenses being down that’s excluding large / notables. You’ll see in our media release that our large/notables are about $100m and third of that was expenses, bunch of little things but nothing really big to call out.

Brendan Sproules: Thanks and just on your CP charge for the quarter, could you help us understand what you've taken specifically around the deferral packages?

Obviously in three months' time when the holidays do expire there's going to be quite a bit of movement across the portfolio so I'd be interested in what you've taken now relative to what we'll need to look at later in the year.

Michelle Jablko: Why don’t I start here

Shayne Elliott: Yes, okay.

Michelle Jablko: You would have seen in the pack our 90 days past due were elevated and we spoke about that in terms of customers that we did put on deferral packages. So that's had an increase in the provision as well as we’ve applied an overlay across all portfolios actually looking at the deferral packages and then on top of that we applied an additional overlay for Small Business.

Kevin Corbally So, one way Brendan of looking at this is that the majority of the increase this year, this quarter I should say, in expected loss reflects the deferral packages and the higher risk segments within commercial.

Shayne Elliott: I mean I think the obvious answer there is as the quarter unfolded it became more and more apparent where the pain was being felt and we can see it in the data, it is the SME sector sadly and we were able to do more work on that and figure out what we thought was a more appropriate number. It obviously is not a sector that lends itself to individual risk review so that's why we used the overlay to account for that.

Brendan Sproules: Thank you.

Operator: Thank you. Our next question is from Andrew Triggs of JP Morgan. Please go ahead.

Andrew Triggs: Thank you and good morning everyone. Shayne, I just had a question, a couple of questions. Firstly, just on the rate environment in New Zealand. A number of economists, including your own, now expecting negative rates last year. I know this was talked about at the last result, but just the expectation for the margin impact perhaps on FY21 if that were to come through.

Shayne Elliott: Yes, good question. It's still pretty early days, Andrew. Look, as you know the Reserve Bank there made that announcement to prepare the market for negative interest rates, banks have to be operationally prepared to do that by December, I think. It is worth pointing out that we are - and again just for the point of clarity - that's the wholesale rates in New Zealand, not retail deposit

rates. That is not been moved by the Reserve Bank, so we are talking about wholesale rates.

You're right, our economists are considering that wholesale rates may be go to minus 0.25%. Michelle, have we done work of what that might mean for people it has an impact on?

Michelle Jablko: I mean it's a bit hard to predict exactly what it's going to mean because it depends on where rates go.

Shayne Elliott: Yes.

Michelle Jablko: What the number is and what the customer behaviour is in the market response. So, it's a little bit hard to give an exact number.

Shayne Elliott: Yes.

Michelle Jablko: But as Shayne has said, we are preparing for it so…

Shayne Elliott: I think that's a fair question and something we should be more forthcoming with at the full year. We will have had time to think that through a little bit more. The other thing I'd say in NZ that there will be a lesser reliance on Wholesale in NZ. A fair question Andrew and we will give some thought about how we can give a better answer at full year.

Andrew Triggs: Thanks Shayne and just a follow up on I guess the messaging that institutional will perform more strongly this cycle than previous cycles. Just back to the collective provision coverage discussion with Brian. I mean the - I think you have 125 basis points of CP coverage of credit risk weighted assets. CBA and Westpac are sitting at 170 basis points. There was a meaningful collective provision charge in the last half, 42 basis points of gross loans annualised. Just interested in some comments on that. It would appear that there was a top up taken for that book in the previous half but is the message that I guess it's no worse than what you had first modelled on that side of things.

Shayne Elliott: So, I think again, going back to something I said before, I think we don't know the processes of other banks, we only know what we do. We know we run a really robust process around that. We know that our business looks different to the others and we also know that in a lot of these models there's an assumption that the relative credit risk weightings are good indicators of true

risk and we don't necessarily believe that that's always the case. As I mentioned, we know in Institutional which we have a skew towards, high level of investment grades, high risk weightings in the normal course of business. And the nature of this crisis looks like it's going to be disproportionally felt at this stage in other parts of the sector. So I'm not so sure this raw comparison of ratios is necessarily helpful but as we said we know our processes are robust. So Michelle …

Michelle Jablko: Andrew, just on your numbers, I think you're comparing total provision charge /CRWA with CP charge (CP/CRWA), so just the like for like is not exactly as you said, but there is a difference. As Shayne said, look our books are not necessarily the same. We hold more capital for unexpected loss through institutional because that's the way that will work and so you would expect the denominator composition to be slightly different

Shayne Elliott: Yes and the business, the book that holds the least amount for unexpected loss is homeowners and on a relative basis we have got a smaller proportion of our book allocated there and the two banks you refer to have a higher, so I think there's a reason. There's a mix issue if you will, and that has to do with the difference in capital and expected losses and the provision for expected losses.

Andrew Triggs: Thanks sorry Michelle, that was an apple versus oranges comparison on the CRWA versus total provisions but thanks for the answers.

Shayne Elliott: Yes, thank you, Andrew. Next question?

Operator: Thank you, the next question is from Victor German of Macquarie.

Victor German: Good morning and thank you for taking the time to answer my questions. I just was hoping to follow up on the revenue trajectory. If my math serves me right, it looks like markets contributed about $900 million or slightly more than $900 million in the third quarter, implying that revenue excluding markets was under $4 billion, which appears to be well below markets' expectations.

I'd be just interested in perhaps a little bit more colour as to what drove that. I'm assuming partially driven by margins, so any more colour on margin trends and any potential volatility in that margin would be I think useful.

On a related subject, Michelle you've guided for a 6 basis point impact from lower rates. It looks like that 6 basis points actually has fully come through in the third quarter. Does that mean that 6 basis point guidance is actually going to be bigger for the full half or is fourth quarter not going to be impacted?

Shayne Elliott: I'll just make a very generic obvious statement. The revenue environment is tough Victor. Let's face it, margins are under pressure, very very competitive market. We're also seeing a continuation of a trend which was the removal and reduction of fees-based income over long periods of time, there's still a - there's still a headwind of that - there's still a tail of that coming through the business.

Despite that, we are growing market share in home loans and doing it responsibly and at a reasonable return. You've got to pedal real fast when you're booking P&I loans. You've got the headwind of low rates - low rates, then that puts pressure on revenue, et cetera.

It's not a great environment, and we're not going to kid ourselves and that's why we've been really focused on things like productivity, about capital efficiency and other things, that's not new. I think the margin pressure has actually become more intense, and our ability as you know very well, to reprice is much more constrained today than it would be historically because of low rates and even on the deposit side, we're reaching some sort of natural limit to reprice there. That's not true in institutional. You've got an ability to do that and we get a little bit of a boost there but the outlook is really really tough.

The only - the tail wind we're going to get on revenue if you will, there will be some volume growth in our home loans business as we mentioned. That will start to come through now and there will start to be a little bit of a tail wind on the volume side into 2021 but boy it's not going to be hugely meaningful.

It is a tough environment and I don't think we should shy away from that. But on the other hand, that's when - this is the type of environment when market businesses shine and they should. We shouldn't be surprised that they're having a good time. If we go back over long periods of time, they are countercyclical businesses. In times of volatility they do well. That's the benefit of having that diversification in our book but I'm sure Michelle will give you more colour.

Michelle Jablko: Yes, so deposits margins, in terms of the other impact from revenue, it's mainly to do with what I've heard others say - in terms of what are transaction volumes. On margins themselves, the 6 basis point I referred to at the half was for the second half and that hasn't changed.

As you look further out, depending on what happens with rates from here. If rates were stable the impacts on deposits is largely true, the impact of ITOC and capital will continue about that and there's a slide at the back that shows you how that will progress.

Otherwise on margins, what's sort of the negatives and the positives. In terms of potential positive, the deposit mix is probably improving a bit, that's potentially positive. On the negative side, we'll get - we've still got mix that will continue to change, asset mix will change a bit in the fourth quarter.

We've got lower credit card spending and we've got continued conversion of fixed home loans and then we've got the drawdown as the TFF.

Shayne Elliott: Yes.

Michelle Jablko: There's probably less benefit – and we had a very small benefit from Bills/OIS, that probably will be a bit less. So we've had few ups and downs.

Shayne Elliott: A little point that Michelle made is that for cards - it's good, customers are doing the right thing, paying down cards, I think that's actually been surprising and counter to what we've seen in other markets locally. People are actually being pretty cautious, sure they're not spending; they're not using the credit card to buy flights and go on holidays, so those balances came down and tend to be a higher margin business.

Little things like that again will slowly chip away and - but the outlook is tough. Next question?

Operator: Thank you. Our next question is from Brett Le Mesurier of Shaw and Partners, please go ahead.

Brett Le Mesurier: Thanks. Two questions; firstly, am I right in assuming that the larger notable items impact - the $99 million adverse impact, that was largely in income, that largely occurred in income, is that correct?

Michelle Jablko: That's correct, yes. It was…

Brett Le Mesurier: Okay.

Michelle Jablko: …it was, yes.

Brett Le Mesurier: The second question I had was looking at the pillar three, the impaired loans from March to June fell from $1.5 billion to $1.3 billion in the write-offs, and I'm talking about corporate impaired facilities, fell from $1.5 billion to $1.3 billion from March to June and the write-offs increased by $65 million - from $65 million to $241 million. Am I right in assuming that the reduction in impairments was because you wrote off the loans?

Shayne Elliott: Yes.

Brett Le Mesurier: Can you comment on the industries in which - to which those write-offs related?

Shayne Elliott: I can't remember. Kevin?

Kevin Corbally: It's a range, one of them is what's been mentioned previously - in the commodity trading sector.

Shayne Elliott: Right, yes.

Kevin Corbally: Would be one of the bigger drops.

Shayne Elliott: Could you hear that?

Brett Le Mesurier: Okay.

Shayne Elliott: Did you hear that?

Brett Le Mesurier: I heard bits of it.

Shayne Elliott: Yes, because it's - the largest - there's a portfolio, but it's not a single but a large part was in the commodity trading sector and we referred to a charge we took in the first half and that was potentially written off.

Brett Le Mesurier: Okay, great. They're all the questions I have, thank you.

Shayne Elliott: Thank you.

Operator: Our next question is from TS Lim of Bell Potter, please go ahead.

TS Lim: Good morning, guys. Thanks for the opportunity. Just going to slide number 10, you have some commercial customers having higher cash inflows and some having lower cash inflows; are these net of JobKeeper payments? My second question is, how can a bank protect itself from businesses that actually fiddle their books to get JobKeeper payments?

Shayne Elliott: The question - the first question you've given was I think how much of that cash inflow was JobKeeper; the answer is, we don't know.

Kevin Corbally: We know that roughly about a third of our Commercial customers are receiving government assistance in the form of JobKeeper, so we do know that and those cash numbers, they will be inclusive of JobKeeper payments as well.

Shayne Elliott: The second question I think - I don't - again, I think second question whether our customers are, I think the word was fiddling - fiddling their books…

Kevin Corbally: Obviously, one of the things we look at when we take on board any customer and we lend to any customer is the character of our customer so that is part of the assessment process that we go through. Outside of that is individuals within that company and their activity and we've seen and we saw even at the half it can be sometimes quite difficult to pick that up in where those results are being then audited by major accounting firms as well. It's a challenge for all of us.

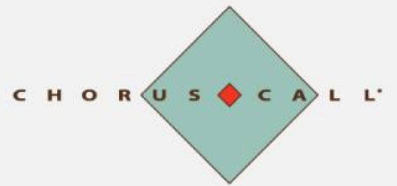
Shayne Elliott: What I will say on that TS is that there's a - as you know, there's a small program where it's - there are small businesses apply for JobKeeper with bank will actually fund that before they get payment from the ATO. That stuff though is pretty low-risk from our point of view because it's well documented, it's well supported by our data is likely to be approved etc..

I think from a risk perspective in a classic sense, I don't think that's a risk but your point more broadly about the word fraud, that is obviously a very complex for us to look at.

TS Lim: All right, thanks.

Shayne Elliott: Thank you.

Jill Campbell: Operator, I think at that point, we're through the questions. Everybody, thanks for persevering with the Stage 4 lockdown sound. I realise that some of what



we've been talking about could have been a little harder to hear than we would like, so we are doing a replay later today but also we will be lodging a transcript and so hopefully that will help make up for anything that you may not have heard clearly as we would have liked you to. The IR team and myself are obviously available through the afternoon if there were any questions we didn't get to and with that, thanks to everyone and stay safe and well.

[END OF TRANSCRIPT]