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IFRS Workshop
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Andrew Bowden
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Good morning. We want to keep this very much as we set out in the day as being a workshop to be as interactive as possible and informal but bear in mind we have about 10 people or so on the phone and we will need to structure the questions in certain blocks of time. So we will go through this particular pack. We have put a pack in front of you with plenty of space to write notes and we will have lots of time to ask questions in those blocks during the session. Thanks for coming and I will pass straight on to Phil to get stuck into it.

Phil Chronican
Chief Financial Officer

Well thanks everyone. We are trying to take you through today where we are up to on the preparation of IFRS and principally what we have in here are discussion of some conceptual issues and also the detail of how it would have looked in our first half results [to 31 March 2005]. And to help me here today I have Margaret Payn, who runs the Group Finance for Westpac and has largely had carriage of the IFRS transition at Westpac, and Bill Starr whose role is Group Controller and therefore he is more across the technical details of many of the issues, and Bill will be presenting later in the presentation.

I would like to start off really just talking about the outline and objectives – I am on page numbered 3 in your pack. What we are trying to do today is provide some clarity for you about what you as the market can expect from Westpac as we present our results under the Australian equivalent of IFRS. Principally to highlight some of the changes and give you an understanding of what these changes are and how they would manifest themselves in our accounts. But also to settle or to articulate Westpac's position on some areas that aren't yet settled. So there is an element of fuzziness on some of the concepts. There is no established practice in one or two areas. What we are trying to do here is give you an idea of how we are thinking about that and in some cases with the intent of seeking feedback from you through time as you get an opportunity to digest what we are saying here.

So if I can move on to the page numbered 5 – Key Messages.

The key messages here are – even though we are changing from one accounting regime to another the business itself hasn't changed although there are a couple of areas where that is not quite correct in the sense that the regulatory capital requirement does mean that the amounts of free capital available for distribution may change and also there is a small extent to which it may change if our hedging activity and practices change in light of the change and the way we account for them. But the essence is that the business tomorrow is the same as the business today.

We want to talk today about the notion of cash earnings. There has been a high degree of market consensus over the last few years about what a comparable performance measure is across the industry. As we change to IFRS obviously that convention breaks down and at the moment I am not aware that there is a replacement convention. What we will be explaining to you today is how we are thinking about that, and we will be seeking your feedback on that issue.

The other messages are that volatility will increase, I think that is something we have all understood and what we will try to do today is articulate the magnitude of that volatility and how it would have played out in the first half for us. And, we will take you through the impact on our capital ratios, but you should see from that that the aggregate impact on our capital position is not something that is material and Margaret will be able to show you later on what 'material' means.

It is important though to restate that the interpretation of the International Accounting Standards is not settled. Many of these standards have been rewritten as part of the new IFRS transition and there is quite a divergence of views in the industry as to how you take a principle based accounting standard and turn it into practice, and the accounting firms themselves are really just getting across this.

I will move on now and just talk briefly about the projects, the project overview. The project in Westpac has been running since early 2003. We have largely run this as a federation of projects. That is, each business unit has been responsible for doing the analysis of the impacts in its own area and then with an over arching group, under Margaret at a group level, to ensure that our centralised GL [general ledger], our centralised accounting services are appropriately structured. We have been running parallel reports since March 2005 so we effectively did a March as a half year in its entirety and then doing monthly, updated in March, in parallel without AGAP reporting.

There are some business processes that change. One of the important changes in hedge accounting is that the group treasury activity, where we hedge our interest rate risk and in some cases our currency risk. Previously internal deals were recognised as if they were external and under the new rules if we wish to get hedged treatment we really have to make sure that we externalise these transactions. So that means that we have taken deals and had to reconstruct them and in some cases we have had to reconstruct the underlying transactions to achieve the desire accounting outcome.

We have also been quite conscious that this isn't just a change in accounting. It changes a whole bunch of things and I guess it is only when you go through such a radical change in accounting that you actually realise how many things hang off it. So things like today like communicating with the external market, things like the way in which we set up our internal performance measurement and reward structures and some of the common language that we use which is grounded in accounting concepts obviously needs to change. So some of these business impacts are important to us. Of course in our industry we are very reliant on the financial statements the customers give us and we have had to realign the way we think about our risk and credit evaluation. So we have work underway to do all of that over that period. We have been amending loan covenants so that the sort of coverage ratios that we are familiar with are able to be meaningfully restated.

We have spent about $20m or will have spent around $20m over the life of the program to convert to IFRS. My understanding from the disclosures of other banks that would put us towards the lower end of that range and that largely reflects the fairly centralised approach we have to our financial system.

In terms of the impact on Westpac financial reporting, interestingly our first public release of IFRS data will be the [December 2005] quarterly disclosure in New Zealand for our general disclosure statement. Given that that [document] usually leads to quite a lot of misunderstanding anyway when it is released, because it is such a hybrid document, I am imagining that we will have to have additional people around to help explain what it means when it is IFRS instead of the normal Australian GAP.

The first time we release our group numbers, at our half year interims, next May and obviously there will need to be some work going in to explaining just what those changes have meant at that point, but hopefully today will lay the foundation for that.

The required comparatives that we will have to produce under the accounting standards don't require us to show the comparative impacts of the insurance and financial instruments, so we will have a situation where the strict comparative data isn't actually the most meaningful for you and in line with what we are doing today we will provide some additional disclosures to help round out that picture for you. Some of those [additional disclosures] will involve estimates, so you will have to bear with us that they won't necessarily be up to the same level of detail or auditable integrity that our formal disclosures will be.

What we are doing today though is trying to give you as full an IFRS equivalent as we can, so we have actually gone back and done the Standards 37, 39 although strictly speaking they won't form part of the comparative. The only thing though that we haven't been able to do is provide you hard numbers on the credit provisioning issue because it is the one outstanding issue where we do not yet have resolution. But we will be giving you some opinion on that matter which will at least give you a clue as to where we are headed with it.

I want to talk now about this notion of a comparative performance measure. There is a high degree of consensus on both the buy side and the sell side of the market that reporting accounting net profit after tax is not particularly meaningful and the items that are most profound in that regard are the distribution on hybrid instruments where they form part of accounting net profit and the amortisation of goodwill. As a result of that, as I said there has been quite a high degree of consensus emerge over the last three or four years that a cash earnings equivalent – and I think we now have the situation where almost every sell side analyst uses an identical formulation which is adjusted for goodwill, amortisation, the hybrid equity distributions and in our case the revals [revaluations] of the hedge activity we had wrapped around the hybrids.

These three items individually are largely corrected for as we move to IFRS. The problem is that while these particular issues all disappear a whole lot of new issues arise that are of an equivalent impact. What we had to think about was, though, that some of these changes are really permanent ongoing changes and they are not really the sort of thing that lend themselves to being adjusted for. They are more of the nature of really restating or rebasing our numbers.

So what we are proposing, and I am now on the page, for those who are listening in which is 8, [13 in the workbook]. What we are proposing is [that] if you think about the differences between AGAP and IFRS on three levels. Those things which are in a sense permanent feature changes, such as the change in the timing of recognition of revenues and so on, really we should just rebase from, you will have a break in the series of our profitability. But they are not the sort of things that lend themselves to ongoing adjustment. There are far too many of them and there is no objective basis for saying what you would adjust them back to.

The second class of item are those where I think an adjustment is still warranted. They are of the nature of the items that formed the adjustment between profit and cash earnings previously and I will take you through those in a second. And then the third of those items, which you will want to understand because they cause the volatility but they again can't really be adjusted for. The best we can do is explain them to you so that you can put them into a context of your own as to how they affect medium term cash generation but again no objective basis against which you would adjust them back to and that certainly includes the volatility arising from hedge activity.

What you see on the table, called Cash Earnings Comparison, is the way in which we would have looked at out half year results for March, how we would do a cash earnings adjustment under IFRS, and how we did do a cash earnings adjustment under Aussie GAP. You will see there that the statutory net profit after tax is not actually all that materially different: $1325m under AGAP, $1313m under IFRS. We took a goodwill amortisation charge of $83m, which we backed out in our cash earnings calculation, there is obviously no equivalent under IFRS. However any periodic charge to goodwill remains a non-cash item and therefore potentially could fit into that column.

We did have New Zealand class share distributions they were [these New Zealand class shares] recognised as ordinary equity that wasn't the cause of any problem under AGAP. It would have been a problem under IFRS, but obviously won't be going forward. So we have shown this adjustment here but obviously it is not an ongoing one.

The hybrid equity distribution does change and we have backed it out there. In the half year you will recall that we had a $40m adjustment for the foreign currency swap on our trust preferred shares that were issued in 2004. Those items now move into debt and therefore the hedge becomes in effect a hedge item and that adjustment goes away. Perversely the 2003 trust preferred securities have been deemed to be treated as equity. We had an interest rate swap on them, not a currency swap, that would in that period have had a $40m adjustment. So we actually do have an ongoing swap adjustment in respect to our hybrids and it wasn't where we expected to end up. I guess our ongoing proposition was that all of the hybrids would have ended up being treated as debt.

The treasury shares issue is one that started to have some currency recently and for those of you who aren't familiar with it, it is the treatment under IFRS where shares held by any controlled entity and in our case that includes the large number of BT managed funds and particularly under the life company, are required to be consolidated and therefore if those funds hold Westpac shares those Westpac shares in an accounting sense are deemed to be bought back. That leads to a very perverse outcome because of course the liability to the unit holder continues to go up and down with the value of the Westpac shares. So we have in an accounting sense an unmatched obligation to the policy holders and are unable to recognise the underlying asset. None of us believe that that feature can persist and that a change will be required through time. But because changes have to go back through IASB we can't assume that that is going to happen in the very short term. As a result of that we will have to be showing you adjustments both on the balance sheet and on the income statement for what that impact has had. Of course we can't predict it because it was a function of the Westpac share price. Typically if the Westpac share price goes up then the item will have depressed reported profit and therefore be a positive adjustment and getting back to a notion of cash earnings.

That would give us in that half a cash earnings number of $1380 that we did report and that would translate into a $1395 cash earnings number under IFRS. Now that may surprise some of you because the general expectation is that our earnings will be lower on average under IFRS than they were under AGAP. We are not arguing that point but we also highlighted that they would be more volatile so what we have is a situation in the first half of 2005 where the volatility was actually positive and therefore we need to explain that. We

would normally have expected our cash earnings under IFRS to be lower but in this half the volatility has actually made it higher.

So if I can take you over – can I just stress that there is no change – there is no credit provisioning impact here and to the extent that we would have lower charges for credit provisioning the cash earnings number would be even higher under IFRS than under AGAP.
I continue now on to page 10 in the pack for those who aren't here, and 17 in the room, had we not had the volatile items in there we actually would have had a lower IFRS number by about 4%. Now can I just stress that that 4% lower, excluding the volatile items, is before any credit provisioning adjustment. So if you assume that our bad debt charge would have contributed 1-1.5 to 2% of cash earnings it is reasonable to estimate that through time we are probably looking at the cash earnings numbers under IFRS being something like 2 maybe 3 % lower, but it is an item that will be more volatile and therefore we can't predict with certainty how that will play out in any given half.

The reason that the volatility arises obviously it is because of our investment portfolios that we hold. You will recall from a couple of years ago that we do have some high grade investment portfolios in our Institutional Bank, although the high yield low quality portfolios are being largely liquidated as you would have seen in the half. The treasury portfolios there are large amounts, which will now have to be held at fair value and therefore that is the primary driver of volatility, particularly those where we have not been able to achieve hedge effectiveness. And of course with incurred loss model for credit provisioning, which is not yet into these numbers, we have to expect that that will lead to some more volatility going forward as well.

This table on the next page just highlights for you that, while we showed $1380 as our AGAP cash earnings for the half, and $1395 in terms of IFRS numbers for the half, there were about $75m worth of what we would have considered volatile items and therefore that's the reason you end up with the cash earnings number actually higher than the ongoing proposition.

I want to talk about one other measure now which is going to cause concern going forward and that is net interest margins. I know that the industry places a lot of importance on margins and trends in margins. However, the change to IFRS means that we are going to, in a sense, redefine what interest margin is and it is going to make interpretation of margin movements very difficult. We will of course be bringing back the securitised assets on balance sheet and therefore any interest income that we receive, and relatively small of course in terms of securitised assets, will be spread over a much larger asset base. There will be quite a lot of volatility between net interest income and non-interest income because of the changes in the hedge effectiveness. We will be having acceptance fees reclassified back in as part of net interest income. There will be a lot of deferral of fees that are currently reported in non-interest income turning up as part of the interest margin through time and that will provide a source of some stability to margins going forward, at the margin. Hybrid distributions of course, the ones that are treated as debt, will now be an interest expense and therefore back in the interest margin analysis. But it is also, once we sort out the credit provisioning item, one of the important features of credit provisioning under IFRS is the discounting of future receivables in terms of specific provision that is meant to be the NPV of the future cash flows you are likely to receive, and an NPV obviously has a discount rate. As that discount unwinds that becomes an item that flows through interest income or interest expense. So that is also important to realise.

So I do suggest a great deal of caution about relying on interest margins as an important performance measure going forward until you get comfort with the way that IFRS is going to be treated.

Some other items that it is worth being cautious about.

Cost to income ratios again commonly used as comparisons of relative efficiency across the banks. The ratio is likely to increase. The principal impact of all of those changes on revenue over time is to lower reported revenues and that is principally due to the fee deferral issue. The amount of revenue we receive is not necessarily any different, but in a period when revenues are growing, and we have clearly been in that for a very long time, the change to the spreading of revenue through the future means that in any one year it is always lower than it would otherwise have been if you had been able to recognise it up front. If we ever do get into a declining revenue environment of course that situation reverses.

The other reason that the expense to income ratio goes up is that we will end up with some additional expense, not least of which is of course the recognition in our accounts for the first time of equity compensation and you will have seen earlier on we are not proposing to adjust our cash earnings for the equity compensation amount.

The adjusted equity measure will be different but it will be simplified a little, but we will have to restate again for the treasury shares issue otherwise we would be providing you a return on equity or an earnings per

share number that would be misleading in the sense that the shares really do exist. We do have to pay dividends on them even if the accountants are pretending they don't exist. And that obviously, all of those changes in terms of the earnings will mean that payout ratio concepts will change as well.

So it is important to make sure that you sort of leave any notions behind about what a good payout ratio is, a good expense to income ratio is, or a good interest margin, and in a sense rebase all of those to the new numbers when you see them.
Let me talk now briefly about credit provisioning. Under the current accounting standards there are two general classes of provision. One is our specific provisions the other are the general provisions, in Westpac what we call dynamic provisioning. Under IFRS we are being required to take a very different approach. Our dynamic provisioning was established and communicated as an expected whole of life provisioning. That is at odds with the notion of IFRS, which is that provisions should be incurred losses and the way in which you go through that is you look at your current impaired assets and you do an individual assessment of them. That is not materially different to what we currently do on specific provisioning but the particular rules about the way in which you discount future cash flows mean that the numbers will change by a small amount.

It is also true that we use our credit provisioning to cover all exposures, whereas under IFRS it is very much related to actual loans. So, a lot of the credit provisions we would raise on off balance sheet items will have to show up elsewhere not as credit provisions under IFRS.

IFRS does allow for a collective assessment of impaired assets where the individual amounts are not significant and clearly that would be used for consumer style portfolios where we will assess the embedded impairment in a portfolio say credit cards or mortgages.

There is however the ability to have additional provisions collectively assessed where losses will exist in a portfolio even though they may not be currently recognised. This is the area where the judgment I think is tested most widely as to just how you would go about this notion of a collective assessment and over what emergence period losses might arise. And because there is no established industry practice nobody has yet been comfortable to say that they are going to be in a position to be certain on their credit provisioning until much later in the piece.

As a result of that when we do the detailed disclosures at our full year result it is most likely that we will still be in a position where our credit provisioning is not able to be quantified and we will just be able to have a discussion about it.

Irrespective of all of that, we think it is unavoidable that credit provisions will be lower and potentially materially lower under IFRS simply because the guiding principle leads you to a narrower definition and it is pretty much unavoidable.

So we are working with the accounting firms and with banks around the world to try and get an understanding of how this works. We have had our people talking to the UK banks, we have been going through continental European banks' approaches to this trying to make sure that we get some understanding about what this really implies.

An interesting issue has arisen, this really is one for the accounting technocrats in the audience, but an interesting issue has arisen with USGAP. It would appear that the European banks that are on IFRS are not making any adjustments to the USGAP numbers when they file them in the US and neither have Australian banks made any numbers. So it is feasible to form the view that USGAP is equal to both AGAP and IFRS even though they can't possibly be the same as each other and I will come back to that issue in a second.

We have had a number of estimates of what this could mean in terms of numbers and as I said we are not in a position where we have finalised anything. But some estimates suggest that the reduction of provisions could be as small as $300m and other estimates are that it could be $1bn and that gives you an idea of just how wide the difference in interpretation is depending on which accounting firm you talk to and depending on which bank you are talking to.

What we also need to know and don't yet know is just what APRA's response to this is going to be. Although we do have a view that APRA's position on this may be a little less harsh than their opening position on it was, when they look at the fact that the European banks of course under the Basel framework run IFRS provisioning with no additional top up and the same capital ratios. So the FSA practice is certainly not to make any adjustment for credit provisioning on this transition. We will come back to that issue in a minute.

Let me just dwell on the issue, the anomaly I suppose, on the international approach to provisioning.

[That's on page 16 for those who are on the phone.]

We have a situation today where none of the Australian banks make any adjustment to the USGAP numbers for their current provisioning practice and neither do any of the UK banks. The UK banks moving to IFRS have had very little change in their provisioning because their approach was largely the same as it was before and yet we are being told that our approach to provisioning is completely inconsistent with IFRS and needs to change materially. So the question is how can we both be the same as USGAP and yet not be able to be the same as each other. And that's exercised a lot of people's minds. But I think the only resolution path you can see to this one is that the USGAP, which is also very principles based, actually allows a wide divergence of practice and it is not inconsistent with USGAP. You could run either the traditional approach to Aussie GAP or IFRS and still be consistent with both the principles and practices of USGAP.

As a result of that, based on what we know today, and again these things can change, it would appear that we will not be making USGAP adjustments either before we transition to IFRS or after we have transitioned to IFRS even though the numbers themselves may materially change.

I just want to talk now about the regulatory capital impact. We received the update from APRA in recent weeks as they have finalised some of their IFRS proposals and they are looking – obviously there is more to come from them but the big issues that we have been interested in are now largely resolved with the exception of the credit provisioning argument. The new approach to hybrid equity limits the innovative elements of hybrid equity 15%. We now know that we are able to issue such a thing as non-innovative hybrid, although I think we all would like to know exactly what a non-innovative hybrid instrument looks like and how much it costs. But presume that there is an industry that will grow up around that very, very shortly. As a result of that the volatility increase in earnings and therefore the flow – the way in which that flows through our capital position is likely to mean that we are going to need to run wider ranges, wider capital buffers. We are not yet in a position to say what they will be but clearly we need to be prepared for the fact that you can't run as finely tuned a machine as we have become used to in terms of capital and dividend generation in this environment as you have been able to previously.

The one thing though that we would have hoped for is that by moving to a common accounting platform globally, we will be able to move to a more convergent approach to capital and as yet we are not able to say that we have achieved that because in a number areas APRA have been somewhat more conservative than the FSA for example in the UK. But we are hoping particularly as we move into the Basel 2 framework that international practice will start to be more harmonised.

I just want to move on to the table now and this is really just to give you the way we view what happened as a result of the APRA changes.

What we have got in the first column is the way we have reported our capital position at 31 March 2005 and then we are restating it under what the rules will be once APRA's transition has fully worked its way through. So you can see that our fundamental Tier 1 of $12.3bn and then the deductions come through. The hybrid limit previously was 25% of that fundamental capital which was $3.082bn number. Under the new rule that would come down from $3.082bn to $2.992bn just because of the difference in calculation basis and calculation base.

And of that the innovative limit would be further limited to $1795m, meaning that there is about another $1.2bn of capacity to issue whatever non-innovative hybrid number looks like.

If you look at where we were in terms of our hybrids what we have done here is we have backed out any New Zealand class share impact because obviously they have been redeemed. What that says is that we had $2.472bn of hybrids all of which would have been deemed to be innovative. That's well within the current limits. If we project ourselves forward to 2008 that particular capital structure would have had us in excess by $677m but as you will see it is not a material issue because January 2008 is one month after the first call date on our domestic hybrid, the FIRsTS. So assuming we are in a position to do so when we get regulatory consent you can see that it would be relatively easy for Westpac to redeem the FIRsTS, issue some non-innovative hybrid and not disturb our core capital position from where we are. And of course none of that analysis takes into play or into account growth in the balance sheet that will occur between this year and 2008. So we are very comfortable that our transition path into the new APRA rules on hybrids is a very controllable one.

That's all I wanted to say by way overview. Margaret Payn and Bill Starr will use the second half of the session to take you through some of the more detail, so this is a natural break point for those of you who may have questions to ask them.

Q&A Session 1:

Ross Brown, Deutsche Bank

Phil just in relation to what will be the basis now on which the dividend payout ratio will be calculated on and also some comments you made a while ago about payout ratios generally for some industry players being too high and need a lower payout ratio given IFRS and capital uncertainty. Have those comments changed in light of what you have learned over the last 6-12 months?

Phil Chronican

Okay. Firstly – the reason we have put through our view of what cash earnings is, is because we think that it is the most meaningful number for driving capital management generally. It doesn't capture every element but it captures the earnings related items that will feed capital. So we would see that as the most important reference benchmark for our payout ratio going forward.

I have already made the point in this pack and it really hasn't changed my view that banks have run, I think I used the term very finely tuned, machines in terms of generating capital, paying it back, buying back shares because we have had highly predictable earnings and we have been able to run very thin capital buffers.

I think that the environment going forward will require us to have a little more flex in that system. You saw that we had a very positive outcome from volatile items in the half to March 31 but if we had had a less – if we had had the other side of that volatility in that period that would have had a material difference in the payout ratio for any given level of dividend. So what we will be doing is looking through time we have very deliberately tried to keep a stable growth path in our dividend through time and that will mean that from time to time we will have buffers in our capital growth and sometimes those buffers will be drawn down on if the volatility in the earnings takes us below what looks like the medium term sustainability of the payout ratio. So I think that does suggest that very high payout ratios will be harder and harder to sustain in a more volatile environment.

Ross Brown

And just around your existing capital surplus, given the hybrid limit will change and the need for more buffer does that mean that the sort of apparent notional surplus that we see is a lot less in reality?

Phil Chronican

Margaret Payn in the second half will give you some estimated numbers on how much of the surplus we think has been eaten up by this transition. But I think my opening point was that it is not a material number and therefore – I think the best way to put it is we now know the worst possible position that we are in because everything that APRA has given us to date is all of the things that could have been negatives, so the only thing that we are now looking at are getting closure on is the approach to credit provisioning and the regulatory capital response to that. But that can only be zero or positive from hereon out. So we no longer face the uncertainty of potential negative impacts we only face the uncertainty of – now that we know what the worst case is – how much better is it going to be than that and that is a better position today than it was in May when we did the half year results.

Brian Johnson, JP Morgan

I just have four technical type questions. Just on the bill acceptance fee, which is really effectively a net margin, will you be basically recording the margin plus the pay out in the interest income and in the expense or will effectively just the net margin figure go in the interest income? It would have quite an adverse impact.

Bill Starr, Group Controller Group Finance

You are right. We will be picking up the gross amount. So an acceptance is effectively a lending arrangement and IFRS looks as it as a loan and a funding and both those will have the gross interest income and expense picked up.

Brian Johnson

It is not just the margin that goes through the income line it is both sides are grossed up?

Bill Starr

Yes that is correct.

Brian Johnson

The second one. Margaret, the same concept with treasury stock, do the Hastings Funds Management Assets basically come back to the balance sheet?

Margaret Payn General Manager Group Finance I don't believe so. They are not in the – it is not where we – we don't control those assets. So the treasury stock we have actually got complete control over those funds, how the funds are invested, whereas with the Hastings assets we are not in that position.

Phil Chronican So the test there is whether the Unit Trust holders control or have the capacity to control and that appears either where we hold ourselves, material amounts over half of the units, and that is quite possible if it is the life company for example investing in one of the trusts. And then the life company's direct … on holdings are consolidated. But funds that are genuinely managed through a responsible entity where we don't actually have direct interest in the funds we don't consolidate those funds.

Brian Johnson Phil, the next one, the general reserve for credit losses that APRA have spoken about, the rhetoric thus far would actually suggest the current provisioning the banks do they are quite happy with it and that they are going to take a part of the general reserve and say you can't distribute a dividend from it. Some of the other banks have made the commitment that the movement in that basically will be included in their definition of cash earnings. Would you …?

Phil Chronican We do not yet believe that APRA has settled that position. You will see later on that under any of the scenarios we are talking about, at least under most of the scenarios we are talking about, our remaining general reserves will be in excess of the APRA minimum of half a percent of risk assets and will be in excess of the Basel expected loss reserves that are required. So I think APRA are having second thoughts about exactly what they think they need to do because they have to come out with an objective test as to what this amount of non-distributable reserve is and because our current practices are quite divergent they are struggling to come up with what they thing that should be. But if that number were to be for example the Basel expected loss number, well then that is well within the range of what we think our residual reserving will be. So I am not sure that it is actually going to be an issue Brian.

Brian Johnson I suppose the point is that the blanket assumption that it always reduces the loan loss charge compared to dynamic provisioning if you are actually doing a dynamic provisioning correctly that's not correct over the cycle.

Phil Chronican Over a very long time actual losses will always emerge.

Brian Johnson Yeah, so?

Phil Chronican Although you will bear in mind that we have had significant buffers in our general provision for some time.

Brian Johnson Phil, the final question I have is, that if you have a look at the adjusted common equity rate that Westpac runs when APRA came out and did a rule change and changed the rule on capitalised expenses everyone reduced their ratio. Westpac have specifically added back in that capitalised expense deduction, basically just saying that it was a rule change and therefore nothing changes. Can you just give us some clarity on what we will see in the next ACE ratio as far as the capitalised expenses go? Will you go back to the treatment the other guys are giving or will you continue to add it back?

Phil Chronican In our discussions with – I didn't … was that much, but in our discussions with the rating agencies they said well make the adjustment but just move your target range by exactly the same amount and we said well that is the same as not making an adjustment and leaving the target range, there is no economic difference. And given how many other things are coming down the pipeline we would rather make those changes as one. So there will come a time when we make that change but it will be in the context of settling an ACE ratio with the rating agencies after IFRS. So it won't be in this result, we won't be making that change. But there is no heat in that debate with the rating agencies because their view was just move your target ratio by exactly the same amount because nothing has changed and our view was well if we don't make the adjustment and don't move the target range then nothing has changed either. Economically it is the same outcome.

Hamish Carlisle, Merrill Lynch: Look I have a few technical questions as well. Just following Brian's question on acceptance fees. Is the same true for securitisation fees? … you will have a gross up of the –

Bill Starr It is. We plan to talk to you about that a little bit later, but as the assets come back to balance sheet and the liabilities sitting in those vehicles come on balance sheet the gross interest shows through and the amounts we picked up in the past which was a net amount and recognised as fee income will become net interest income.

Hamish Carlisle So it will be gross interest and interest expense?

Bill Starr Yes that's right.

Hamish Carlisle The second question was in relation to the externalisation of hedge contracts. Is there any cost in doing that given that the amount transacting in the market, the transactions that otherwise wouldn't have existed, just in terms of … spread …?

Phil Chronican They are small, given the size of the transactions we are talking about and the competitiveness of markets our people tend to transact you know at the skinny end and in many cases these transactions have been done like as a job lot, so there is not a lot of spread left with the other counterparty banks. But there is a cost in an economic sense in that we are using credit capacity and acquiring exposure to counterparties and therefore it does, even though they are high quality counterparties, and therefore very low risk assets, even under the current Basel 1 framework, there is sort of an economic cost in the sense that we are acquiring counterparty credit exposures where otherwise we wouldn't have. Now again they are all at the professional end of the market but are subject to netting, so you know in aggregate is it material? No, but obviously we externalise stuff that was previously internalised and at the margin that does have an impact.

Margaret Payn We also obviously … in the same position we have been on the other side where they have had to externalise their hedges.

Hamish Carlisle Has that process started yet?

Phil Chronican It started some time ago.

Hamish Carlisle The third question was just in relation to more probably for the second half but the balance sheet adjustment for capital purposes related to the defined benefit surplus that you have got?–

Phil Chronican Why don't we leave that because Margaret is going to go through that sort of stuff anyway.

Andrew Bowden Look of there are no more questions, we have got no questions on the phone, will just take a quick five minute break, grab a glass of water and we will come back in about ten minutes time.

Second half of the presentation

Starting at: Slide 37 of the work pack used on the day or
Slide 20 in the presentation on the Westpac Investor Website

Margaret Payn
General Manager Group Finance

It is Margaret Payn talking for those on the phone. Bill Starr and I will now run through things in detail. So what Phil Chronican has given you an overview of we will give you some real detail. So I hope you don't fall asleep.

So we are covering the individual items – I am going to look up every now and again to see how much attention you are paying and ask you questions. So we are going to cover the individual impact of IFRS including, as Phil said, the standards on financial instruments and insurance contracts and again it is on the March 2005 half year data. So wherever you see numbers it is only six month impacts. We have – again I will reiterate, no impacts from changing our policy for credit provisioning are included, and we have also ignored any deals, any complex deals that might have been impacted by the hedge accounting but that actually terminated in our 2005 year because there is no point in re-doing those. Again some of the treatments aren't finally confirmed yet. The exact approach to deferring wealth fees, booking day 1 profit and loss, which is something that is in our investment bank, and also the classification of the hedging outcomes between interest income and non-interest income – none of those are completely settled yet. You have got estimates in the information here. We have also, to make sure that people don't take these as the absolute gospel truth, rounded the P&L numbers to nearest $5m and the balance sheet numbers to the nearest $50m, which is why you won't be able to tie them exactly in to what we publish in March 2005. We haven't had the data audited, it won't be the same as the statutory comparatives that we will show you in March next year. The reason being that we are including the fuller impacts of the financial statements and insurance standards which won't form part of the statutory comparatives.

Now, if you move on to the – the people on the phone slides 21 and 22. What those show we have got here detailed reconciliations of the profit and loss account and the balance sheet. So both of the sheets have got all the adjustments between what we reported in March 2005 on the left hand side and then there is the whole load of columns which are the same on each page, so it gives you the P&L impact and the balance sheet impact to arrive at the full IFRS comparative information. So Phil summarised the impacts that you are seeing at the bottom of the cash earnings sheet for example, that will look familiar to you and you can see how that pans out.

So on the first page, which is the comparison of our current published earnings for March 2005 and the IFRS earnings, what you will see is that the first set of columns right up to treasury shares, those are the columns that are going to have an ongoing impact on our cash earnings profile. The last column, the fair value hedging column, fair value and hedging column, sorry, is the column where all our earnings volatility will arise. So you will see that as a rebase, I think that is what Phil referred to it as, you have got three items, being fee revenue, deferred acquisition costs and share based payments, which collectively for that March period would have reduced our earnings by $60m. The effect of the fair value and hedging numbers is an increase of $75m and that could easily have been a decrease of $75m. We do think that that is a fairly normal sort of number so we are not expecting an enormous number to flow through that column however that sort of magnitude isn't a surprise to us.

So moving on to the balance sheet, we have got the same disclosure there. We have got three main impacts. On the balance sheet we had reported equity of $15.5bn at March which reduces down to $12.2bn under IFRS and there are three major changes: the treatment of hybrids which Phil mentioned earlier where these get reclassified as either minority interests or debt or loan capital within liabilities; we have also got an impact there of nearly $3bn. We have got the securitisation number where we are actually consolidating for the first time a whole load of vehicles which is going to gross our balance sheet up by around $8bn. And then the last item is just another grossing up of the balance sheet where the off balance sheet derivatives that we will gross those up we will mark to market the offsetting derivatives and put those onto the balance sheet instead of netting them off and that will gross assets and liabilities up by about $4bn, so no impact on equity but just more assets, more liabilities.

So that is the overview. And what we will do now is Bill Starr and I will take it in turns to run through each of those columns to explain to you what the changes are. So Bill can start off with hybrid equity instruments.

Bill Starr
Group Controller, Group Finance

Thank you Margaret. The way we would like to do this is we have got two slides for each impact. The first one covering off the current position and how that changes with the move to IFRS. And then a second slide which goes through the impact of the P&L balance sheet, volatility in any business impacts. Apologies, it does sort of cover these things twice in some cases because it does take a bit of getting your head around them. So I am sure that won't hurt.

On our hybrid instruments - as you have already heard the instruments we have at the moment are all treated as equity in our balance sheet and any distribution from those instruments are treated as appropriations and profit and so they don't impact P&L. These are then adjusted back in our cash earnings measures to sort of come back to our true cash earnings. We also noted that included in the numbers here in the starting point is the New Zealand class shares hybrid, and as we have heard, in July it was exchanged for ordinary shares. That capital is now effectively part of ordinary capital. Under IFRS stricter rules actually apply on which instruments actually get classified as equity and which of them might move to debt and as a result the first of our 2004 TPS instruments will move to a debt classification and the 2003 TPS instruments shift to minority interests instead of being part of shareholders equity. For the ones that go to debt the distributions become interest expense and for the ones that move to minority interests that is also taken out of profit attributable to shareholders and goes into minority interests classification.

So moving on to the business impacts. In the P&L we will see a reduction in net profit after tax attributable to ordinary shareholders of around $90m as a result of those changes and that is the distributions on those three instruments shifting position. Although this obviously has no impact on our cash earnings figures. On the balance sheet the two instruments moving to debt, will shift into the loan capital line and again the 2003 TPS instrument moves to a separate part of equity which is the minority interest part.

The changes also mean that existing volatility in NPAT related to the cross currency swap on the 2004 TPS, which Phil mentioned, will disappear and that will achieve some hedge accounting going forward with the underlying being a debt instrument. But there is the new source of volatility from the 2003 TPS interest rate swap which did classify as being a hedge instrument for AGAP and we can't achieve hedge accounting for under IFRS. Again these have minimal business impacts as APRA has indicated that as a result of their recent paper on T1 instruments that this is not going to have too much of an impact on us.

Margaret Payn

Okay. I will cover now the next two items, which are fee revenue and deferred acquisition costs.
It is interesting because I think fee revenue there is quite a divergent treatment of this across the industry. We currently segregate the fees we receive up front between fees we receive for recovering costs and fees that we receive for risk and the first fees we do account for on a cash basis so as we receive them whereas the risk fees for doing the business we do spread those over the life of the transaction. All fees are currently included in non-interest income. Now going forward under IFRS we will defer more of the fees and recognise those over the life of the transaction rather than recognising them on a cash basis. So application fees, line fees, credit fees and that means mortgage application fees, for example, we have taken some of those up on a cash basis at the moment. Those will be wrapped into an effective yield type calculation and will be recognised on an IFRS basis over time. In addition to that we will – where the fees are to do with lending and to do with yields they will go into the net interest income line so there is quite a shift there. So where Phil spoke earlier about being very careful about net interest margins you will see some fees moving from non-interest income into net interest income.

Looking at the March 2005 results what would that have done to our financial statement? We would have had a reduction in fee revenue of $20m and increased expenses of $5m. We would also have reclassified the income from non-interest income to net interest income. On the balance sheet establishing the deferred fees would reduce shareholders equity by $150m. It doesn't have a great impact on volatility all we are doing is lagging the change in level of fees that we are receiving at the time and that's about it. So it is not material and at the moment we are not quite certain about the capital treatment for this so Brian raised earlier a question about capitalised expense, we are not quite sure how this is going to be treated.

On deferred acquisition costs, this is really our wealth business. At the moment when we sell wealth products we receive entry fees and we account for those on a cash basis. We also defer the costs of acquiring the wealth business over the life of the product. Under IFRS we will be deferring those entry fees over the average life, in other words, the average holding period of those investments by our customers. And also we will be able to defer only a certain type of cost going forward so those are incremental acquisition costs. At the moment we can estimate or we do estimate the all in cost of putting on some business and we

defer that. Going forward it will only be incremental costs such as sales related commission that we can defer. This is one of the areas I mentioned upfront is still open to change so we haven't completely settled on the treatment yet.

Margaret Payn

I will just tell you what the item impacts are – so the impact on the March accounts would be to defer income by $15m and again there is another $150m of balance sheet adjustment for deferred fees and again exactly the same as for the fee income, there isn't a great a volatility impact. There is an impact I guess on capital because whatever we have to set up on the balance sheet in the wealth business is then not available to dividend up to the parent entity for capital management purposes.

Bill Starr

Moving on to goodwill. The existing position on goodwill in Australia is that it is generally amortised on a straight line basis over 20 years, in Westpac's case, or it may be a shorter period if that's the period that the benefit is expected to arise. So goodwill does disappear over time. Under IFRS this goodwill amortisation ceases and so the P&L charge disappears. However there is an impairment test required to be done at least annually and more often if there is an indication of some impairment coming up which is based on a very specific cash flow or discounted cash flow test and interestingly this test is actually well specified in the accounting standards and it is not necessarily the you would use if you were valuing the business independently. So although we have no indications of it leading to any write downs at the moment, the different in test could lead to some interesting outcomes in the future. So the impact on our profit and loss for the period to March is that the goodwill that was amortised around $83m would actually get reversed on an IFRS basis and obviously that has no impact on cash earnings. The other side of that impact is in the balance sheet where goodwill actually increases back to the balance that existed at 30 September and pretty much gets fixed there going forward. The only chance of volatility is if there does happen to be an impairment at some stage in the future and the regulatory capital impact of this is very minimal because goodwill is already deducted for regulatory capital and that treatment will just continue going forward.

I guess getting onto an area which can be a little bit more interesting to get your head around is consolidation and particularly around our securitisation vehicles. Under existing Australian GAP the decision about whether to consolidate something is based very much on control and as a result there is a number of vehicles where we have involvement with them where we provide services to those vehicles but don't take any direct credit risk in those vehicles and they are not included on our balance sheet. This includes some of the Waratah conduit vehicle and a lot of mortgage securitisation vehicles. Under IFRS the definition of what you should consolidate is much tighter and there are additional tests that have to be applied quite strictly around residual risks and benefits in vehicles. And these are given greater weight in the decision and so a number of vehicles or the ones I just mentioned particularly Waratah and the securitisation vehicles will need to come back on to our balance sheet and there is also a number of much smaller vehicles which also will be impacted by this.

In terms of how that impacts the P&L there will be no material impact overall but as we have already discussed today these vehicles in general hold fairly large balances of assets and liabilities which earn interest and incur interest expense and in our profit and loss account we will have to gross up our interest income and interest expense for these figures and the net amount that we pull out of the vehicles will have to then become part of our net interest margin rather than being shown as fee income as it is at the moment and the impact of that movement is around $25m. The assets and liabilities come on balance sheet and involves a gross up of around $8bn and in terms of volatility there should be no impact and in terms of the business impacts APRA's indicated in their paper that came out at the end of August that there is no real change to their approach on this and they are separating the accounting from the regulatory treatment and so it won't really impact us in a regulatory sense.

Margaret Payn

So moving to share based payments. We have a number of equity based remuneration plans and we currently don't recognise a charge for the cost of those plans in our earnings but we do disclose in our annual financial statements the value of the awards given to staff. Under IFRS we will charge the value of share based payments to earnings and there will be a corresponding entry to a new reserve within equity. Okay, so it won't impact shareholders funds. The value will be charged over the vesting period which is up to four years and the plans have different vesting periods. And we will also, although we do provide information in the notes to the accounts at the moment it won't be the value that is awarded to stock because we will be at the group level making a discount to reflect staff attrition rates. We made the election to include all

instruments on issue at the moment because that means we will always have a normalised charge going through instead of ramping up a charge over the first two or three years.

Looking at our March 2005 financials we would have recorded an expense of $35m for the half year in the first half and we are not proposing that to be a cash earnings adjustment. We see that as a real cost of business. On the balance sheet we will have a very minimal increase in liabilities – this is for our standard employee share plan – but there won't be any other impacts because whatever we charge through earnings will be offset in the equity reserve. This won't cause volatility and we are from a business perspective, we are investigating at the moment, how to structure the scheme so that we may in future potentially source shares for example and get tax deductions. At the moment we are not putting any tax deductions into the information but that is something we are looking at.

Moving on to treasury shares now. I think this was covered really very well by Phil but effectively we do have a number of vehicles in our wealth business, which invest in Westpac shares and where we hold a controlling interest. So where we have got more than 50% of the units on behalf of our customers for instance in the life funds then we have to consolidate those vehicles and it is where we have to consolidate the vehicles that we have to back out the Westpac investments so you get a very strange outcome. So the impacts are going to be on the actual equity base from an accounting perspective and on the earnings statement and also the number of shares that are used in the statutory earnings per share calculation. If we had had this standard in place for March 2005 we would have had a reduction in earnings of $20m because that was the value of earnings coming from those particular holdings. There would have been a reduction in assets in shareholders equity. This will cause volatility at the reported net profit after tax level but of course it is one of the items where we are going to be recording it as a cash earnings adjustment so it should not affect cash earnings. We will always publish information about this so you can see through it.

We are considering how to report the adjusted earnings per share because clearly it doesn't make sense not to include the shares that are on issue and that we have to pay dividends on. We don't expect a regulatory impact out of this so I don't think APRA is going to use the accounting information.

Over to Bill Starr for the last couple of things.

Bill Starr

Moving on to our defined benefit plans. Westpac has already for a number of years followed the principles of international accounting standards in accounting for our defined benefits superannuation fund or funds. The approach that is used therefore results in the recognition of an expense for these fund members represented by the current service cost or the accrual if you like for the employees that are there at the moment and still working. Interest costs, because the liabilities are discounted, and factoring in the expected returns on the plan assets is all calculated by an actuary. Any excess over a threshold which is 10% of the greater of the plans assets and liabilities as either a surplus or a deficit would be amortised on a straight line basis into our earnings. So this method effectively contains a smoothing mechanism, which recognises that volatility in the surplus or deficit that might be there is an expected outcome and instead of taking it directly to equity as some of the other methods do requires its recognition through the P&L over a period of time. So as we move to IFRS since we have already applied these rules the same principles will continue to apply going forward although the amount of the surplus that we currently show will be adjusted back to the current actuarial value in our balance sheet.

In terms of the impacts then, on the P&L there should be no change to our expense. As I said the previous application of the IFRS principles gives you the same number and the actuarial losses that we hadn't recognised at the moment are within that 10% threshold and so there has been no amortisation hitting our P&L at the moment. However our equity amount and our balance sheet assets will be reduced by about $150m which is the figure, which is the difference between the accounting asset if you like and the actuarial calculated asset as at 30 September last year.

This resetting of the surplus to its actuarially assessed value at that time will reduce the probability of any volatility so that in the near future from the funds as the funds surplus or deficit, if it may arise, would have to move so that full 10% amount before volatility – any amortisation of that amount and therefore volatility would start coming through the P&L.

In terms of our regulatory capital there will be a change related to this as APRA has decided that any surpluses cannot be – different to the current situation – can't be included as part of capital and any deficits must be deducted from capital so the surplus that we currently have there of $300 - $150 of that goes as a transition adjustment and then $150 effectively goes off capital as APRA ceases recognising it.

Moving on to the impacts of fair valuing and hedging. Our current position under Australian GAP is that our trading portfolios are held at fair value and other assets and liabilities of the bank are generally held on an accruals basis. Derivatives we currently hold that are considered to be effective hedges are recognised on a basis that matches the recognition of the underlying risk that they are hedging which generally means that their fair values are on an off balance sheet basis. Under IFRS there are changes to the way that we recognise many of our assets and liabilities as already covered and these changes include that certain treasury portfolios and some of our investment portfolios will start to be recognised on a fair value basis instead of an accruals basis. Some instruments, particularly in those fair value ones which are currently valued using a mid-price will have to shift to a bid offer price. The impact of this is not as big as you might think it could be largely due to the fact that you are allowed to have offsetting risk positions and treat them and those on a mid price basis and most of our assets and liabilities seem to be matched so they meet that test. Under IFRS all derivatives do get picked up at fair value on balance sheet. And hedge accounting is only permitted when specific requirements including fairly onerous documentation procedures and effectiveness testing are met and any ineffectiveness on hedges hits the P&L straight away. It also sees the creation of a reserve within equity that relates to cash flow hedging.

In terms of the impacts that has we have already noted that for the six months to March 2005 the impact of these changes was to increase in a volatility related sense pre-tax revenue by about $110m and after tax by about $75m. This change is also likely to result in some degree of volatility between net and non-interest income related to hedge effectiveness or ineffectiveness depending on the finalisation of our accounting approaches to that.

On the balance sheet the main obvious impact is the grossing up, we have already discussed, of around $4bn which largely relates to treasury's hedging portfolio, which now comes on balance sheet.

Income and equity volatility will occur related to fair value management measurement being applied. However some of the investment portfolios we have are currently in run down mode and we would expect some of this volatility to reduce over time.

Again we have already mentioned that our economic strategy towards hedging has not changed although some of these activities cannot achieve hedging under IFRS and as a result there will be some volatility remaining. There are also some deals that are being restructured so that hedge accounting can be achieved and treasury has changed its processes so it now deals directly with the external market rather than through our financial markets business to help achieve that hedge accounting outcome. So as an additional impact which won't hit next year but will hit in 2007 is that our hedges for our New Zealand dollar income will no longer achieve hedge accounting in the 2007 period.

Margaret Payn

Okay. So what does that all mean from a capital perspective. [This is on the telephone slide 41.] We have summarised there the effect of the adjustments just described and what they have on the capital base – the accounting capital base and the regulatory capital. We have included an estimate for credit provisioning here. It is very, very large, which shows you how uncertain we are around the outcome at the moment. Overall in the total column we are not expecting the capital impacts to be very material and why is that? It is because the remaining provision levels that we have included at the moment on our large range of estimates for credit provisioning will still be above the 0.5% risk weighted assets that represent the APRA minimum and also remain above the level of provisions that would be required under Basel 2 and we feel that that adds some support to our view. In addition we know that the FSA isn't suggesting that there is any change to the IFRS numbers.

So as you see there we have got a range of -$350 to $150 or -$300 to $200 for the various levels of capital and we don't see that particularly material on a capital base of $12bn. I am sure there will be questions about that later.

On the expected timetable I think Phil covered this briefly earlier, but we are publishing our 2005 financial report in November and our Stock Exchange announcement. In that report we will be disclosing some IFRS information on the impact on the opening balance sheet in the notes to the accounts. Then we will be publishing a 2005 transition statement which will include the opening balance sheet and our final 2005 information on a pro forma basis and we are aiming at February for that so that's well in advance of any of our numbers coming out. And then clearly the first half 2006 profit announcement will be on an IFRS basis and we are aiming at providing more information because that will not – is not required to have the derivatives an insurance information in it on an IFRS basis as a comparative. So the first profit announcement out in May 2006 and I am sure you are all looking forward to it.

That's the presentation.

Q&A Session 2

Nick Selvaratnam, CSFB

Phil, restatement of P&L and balance sheet aside, on a go forward basis in an operational balance sheet sense are there any structural changes in the way Westpac would operate its business as a consequence of some of these changes on an ongoing basis rather than a once off. For instance, and perhaps this is more a reflection on Basel 2 rather than IFRS, but there are some significant incentives being provided as we head towards Basel 2 to securitise an increased level of assets that are non-residential because the risk weightings will be reduced from half a percent to 25%, and therefore in an ongoing sense there could be some significant balance sheet shifts in terms of how best to run a book. Could you enlighten us on that issue or anything else where there will be any changes going forward?

Phil Chronican

Okay I can't be 100% certain on that Nick, because you know we are all going through a bit of a journey of learning at the moment. The Basel issues that you refer to I think it is important to bear in mind I don't think there is a bank – none of the major banks anyway in Australia today would say that they drove their business strategies off regulatory capital ratios. Rather they look at the regulatory capital ratios as being a constraint that they have to work within. So just because a home loan goes to a lower risk rate doesn't mean that we would view from our internal capital allocation models we would view it materially different. However regulatory capital acts as a constraint on activity so you end up capping a certain style of activity where the regulatory treatment is way out of alignment with the true economic risk. What the Basel framework holds out for us is that the divergence is less and therefore our existing views about true economic capital can prevail and that will, at the margin, have some impact because we would do things today that are designed to achieve regulatory capital outcomes that would no longer make sense to do. So some securitisation activity you might not bother doing because you are already getting the recognition that it is a lower risk weight today than – you are getting that recognition flowing through. So that would be an example where we would be more inclined to hold assets on balance sheet because there isn't a regulatory capital constraint around it. But that, as you say, is more of Basel issue than an IFRS issue. I think the only areas where we would end up changing what we do today because of IFRS relate to the hedging activity that Margaret just touched on towards the end there. Whereas today we have or to date we have been hedging a year ahead our New Zealand earnings because that has lowered intra period volatility in our reported earnings so we know with some certainty how we will be translating our New Zealand earnings as we go forward on a half by half basis. Because we would need to mark to market the currency hedge going forward our reasons for doing it no longer are meaningful. Now we may still choose to do it because we want to achieve an economic certainty around it but you know the initial reason for doing it was actually to hedge an accounting outcome which is not going to be effective any more. There are similarly some activities within treasury where we have been engaging in hedging to provide some stability in the margin through time and if that is not going to be effective we have to wonder why did we do it anyway. So I can't rule out the prospect that some of our hedge activity will change but we are trying – we are testing ourselves I guess to make sure that if the hedge had a real economic purpose then we shouldn't change that practice just because of IFRS. But there are isolated cases where things have been hedged to achieve accounting outcomes in which case if that is not achieving that outcome then why would you go through the cost of doing it.

Nick Selvaratnam

Just to clarify Phil on the subject of securitisation, from our understanding the biggest arbitrage actually is on non-residential lending where the risk weightings could drop from 100 to 25 per cent, a significant release of capital effectively. Are you saying that that would not influence Westpac's forward strategy?

Phil Chronican

I am saying it will have some influence. Let me turn it the other way around. If you look at the way in which we acquire credit exposures in our institutional bank many of those credit exposures are with extremely highly rated counterparties but under the current Basel rules are 100% risk weighted. That leads us to having a really tight management of the way in which we acquire, we engage heavily in netting for example with professional counterparties, even though they are relatively, you know, banks obviously are lower rated. If they are large corporates then everything is 100% risk weighted. When move to actually getting true economic capital around them we are not

as constrained as we are today. But our pricing models today already use our internal economic capital approach to it which is the same as or similar to where we will end up under Basel. So our pricing – our view about pricing won't materially change, what will change is our regulatory restraint will be taken away which is we have to effectively cap those things more tightly than we would like because the old Basel standardised approach puts a regularity capital hurdle around it. So yes there will be some hurdles and some constraints removed but we already think about these things in terms of their risk rates and so on. So yes there will be changes but I don't think they are as profound as some people in the market are saying because a lot of the more remote market commentary implies that we currently run the bank by the old Basel 1 standard approach and that is not how we run the bank.

Brian Johnson, JP Morgan I apologise for labouring the point, but if you have a look at slide 79 in the pack in the room we have got in front of us the credit provisioning release, tax effected, you are saying it is $200-$700m of positive capital release but there you specifically say *and no additional general reserve for credit risk*?

Phil Chronican Yes.

Brian Johnson APRA have a discussion paper that doesn't provide a hell of a lot of clarity but it does say that they are proposing a general reserve for credit losses.

Phil Chronican My understanding is from our discussions that they have dropped that language.

Brian Johnson Taken it out?

Phil Chronican They appreciate that you can't set up a reserve, you need an accounting standard to set up a reserve.

Brian Johnson So it disappears totally?

Phil Chronican They are still grappling with the issue, which is can they constrain the release of capital and I still believe they will attempt to bound it. But the issue at the moment they have got is that – take their ingoing proposition which is they did not want to see a wholesale release of capital just because there is a change in accounting standard. We understand that and we are not out of sync with it. We then look at what are the objective tests that APRA can have. They currently have two tests that they can look to, in fact there are three. One is they currently have a minimum which is a half a percent of risk weighted assets. All of these numbers would meet that test in any event. So there is no breach of even the old APRA standard with this lower level of provisioning. Secondly they have now through the Basel 2 accord we have a new definition which can be objectively measured across banks of an expected loss using the Basel factors which would give you a provisioning level materially below what we currently hold today. That again is an objective test that APRA has endorsed as the go forward position. Thirdly is the comparison that they don't like us to use which is that the FSA simply accepts the IFRS numbers as they are. When APRA have to come out with a requirement either to say that we have to have a minimum level of reserving which is unlikely because they are not trying to change the accounting standards or that they will increase our capital ratios or requirements by the amount by which our current, our proposed reserving doesn't meet some threshold then that requires them to describe what that threshold is and at the moment they have been unable to articulate to us what they think that threshold we need to meet is. Our believe is that irrespective of what threshold they settle on there will be some release of capital from our current level of dynamic provisioning (DP) because of the high degree of conservatism that we have used in setting our DP.

Brian Johnson Can I just ask – just on the same page – Margaret I would be interested to understand why the deferred acquisition cost doesn't basically flow through into the ACE or the Tier 1, given that economically it looks to be … probably right?

Phil Chronican Bill can help me here. It is because it flows up through the wealth management subsidiaries and therefore it is already captured in the deduction from the subs and not at the bank level.

Bill Starr That's right.

Brian Johnson Sorry to labour the point, doesn't it mean that it is coming out of total risk weighted capital and not out of Tier 1?

Phil Chronican No, because I think it is already lost – it already forms part of the minimum cap. That is already deducted out of the –

Bill Starr Well it impacts the amount of our effectively carrying value of the wealth subsidiaries which are deducted. So –

Brian Johnson … Tier 1?

Bill Starr Well we may work through that impact.

Hamish Carlisle Hamish Carlisle again. Phil just to follow up on the defined benefit plan it was more of a question of defining cash earnings in the sense that you have got an asset here that the regulator deems to be intangible, you are amortising that asset. Why wouldn't you add back the amortisation charge through the P&L and the determination of cash earnings? It is not as a big an issue for Westpac as it is for one of your peers and I think that is probably where it is relevant in terms of –

Phil Chronican I guess it has just never occurred to us that the issue is immaterial, it is not today a cash earnings adjustment. I didn't think that the transition to IFRS was an excuse for inventing new cash earnings adjustments. Through time it is a real expense because the thing disappears so why not – in a go forward sense ultimately all these balances erode and we end up paying our expenses and it seems to us better to get a common base across the industry where we recognise an expense for superannuation.

Hamish But there isn't a common basis. The Commonwealth Bank … …

Phil Chronican Well the purpose – Brian just made the point - that one other bank's not doing the same thing. I guess the purpose of putting these out here is to have the debate in the industry and get some consensus. This is our view. You have to form your view. We didn't get to the current definition of cash earnings by everybody simultaneously landing there on day one we got there through a process of people converging and agreeing and debating the issue. So the purpose of today was to put out a view that we think makes sense and seeing whether you agree with it. If you don't then we are not locked in. If the market feedback on these items is that some there are some other adjustments that we should have or some of the adjustments we are making are inappropriate then we are open to hearing it but we felt that the debate needed to be had and therefore we needed to put a position out there to form the basis of that debate. So we are not – I am not sitting here as an arbiter on this thing, I don't think any of us can be that. What we are trying to do is to help make a contribution to the evolution of a consensus view I happen to have the view that in the long run pension expense is a pension expense just like equity compensation is an expense and ultimately we are all going to end up paying 9% of our payroll and the sooner we get our mind around and recognise that is the long run cost the better.

Hamish Thanks for that.

Andrew Bowden
Head of Investor Relations

There are no further questions. There are no questions on the phone either. I think we might wrap it up. Thanks very much for coming this morning. Thanks to those who have dialled in as well. Good morning.

END OF TRANSCRIPT