Australia's First Bank
Annual Report 1997

“To be **first**

you have to be thinking first”

Susie O’Neill, Olympic Gold Medallist, employee of Australia’s First Bank

First says some important things about Westpac and the way we approach our business. It reflects who we are and where we've come from as pioneers in the Australian banking industry. Just as importantly, it provides a clear and positive expression of where we aim to be in the future – first in delivering better solutions to customers, first in inspiring staff to superior performance, first in supporting our communities and first in accountability to shareholders. Striving to be first is a cornerstone of our culture. It represents a distinctively Westpac attitude which drives us to exceed expectations. This report explains the importance of being Australia's First Bank and how we're thinking first in everything we do.

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New Life

October

AMPAC Life becomes Westpac Life again. The $343 million purchase from AMP has positive financial and operational implications and allows Westpac to provide customers with a superior value financial services package.

Doorway to Asia

November

Our exclusive tie-up with Standard Chartered Bank (SCB) gives customers access to an Asian network larger than all other Australian banks combined. The relationship opens the door to SCB's more than 250 offices in 21 Asian countries.

It's coming together nicely

November

With service spanning 136 years in New Zealand, the merger between Westpac and Trust Bank creates WestpacTrust, the largest bank in the country

Olympic Games

January

Westpac staff, customers and shareholders are the beneficiaries when Westpac is announced as Official Bank and Official Partner of the Sydney 2000 Olympic Games.

Another first

March

Not only the first Australian bank to centralise its offshore financial markets transaction processing and accounting, Westpac becomes one of the first banks globally to achieve this for derivative products.

Family awards

April

Westpac's support for work and family results in winning the financial services category of the Australian Financial Review/Business Council of Australia, Corporate Work and Family Awards. The award recognises Westpac's innovative staff programs including Family Carelink, paid adoption leave and the Employee Assistance Foundation.

Paris invite

April

Through our support for Australian women in business, Westpac is the only Australian bank invited to attend the OECD conference on Women Entrepreneurs held in Paris, where both Westpac's and the Australian Council of Businesswomen's work was praised as first class.

180th Birthday

April

It began in 1817 as a small office in Mary Reibey's house *(above)* in Sydney's Macquarie Place. In April 1997, Westpac celebrates 180 years of continuous business in Australia.

Best bank

May

Westpac is named Australia's Best Domestic Bank in the prestigious *Finance Asia* Country Awards as voted by regional corporate treasurers and international debt and equity investors.
The award recognised Westpac's product and service skills in the institutional and wholesale banking areas.

Winning Challenge

July

Westpac's regionalisation strategy receives its loudest vote of approval when Western Australia's Challenge Bank is named Regional Bank of the Year, citing customer improvements such as more convenient access and a wider product range.

Merger approved

September

Bank of Melbourne shareholders voted to approve the merger with Westpac. Through recent mergers more than two million customers have been added to Westpac's client base.

Home and away

September

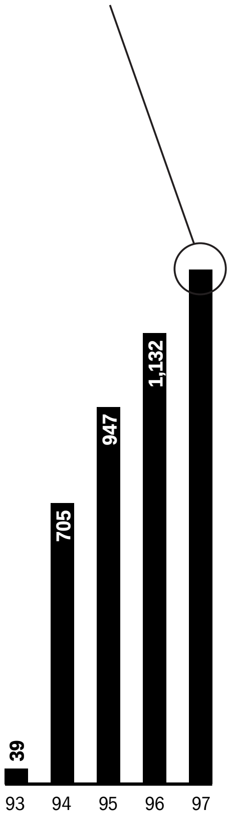
In a first for a major Australian bank, Westpac securitises $715 million of its home loan portfolio through a public issue to overseas investors and has now securitised over $3 billion of loan assets.

As Australia's First Bank we have 180 years of experience in building shareholder value

This year Westpac celebrated its 180th year in business. Westpac is Australia's First Bank and indeed the only bank to have kept its doors open continuously throughout the development of our nation. We have a tradition of working side-by-side with our customers and of creating value for our shareholders.

Our 180th year was also another solid year for Westpac. Against a background of unprecedented change and falling interest margins, we made steady progress on our primary financial objective of improving returns to shareholders. Our earnings per share rose 18.8% over last year to 70 cents, while the return on ordinary equity improved to 17.0%. Net profit after tax was at a historic high of $1,291 million, up 14.1% on last year. The Board has declared for shareholders a fully franked dividend of 39 cents per ordinary share, an increase of 18.2% on last year's dividend.

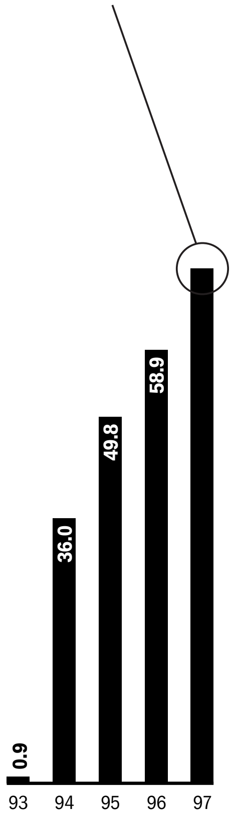
$1,291m



Profit

Operating profit after tax attributable to shareholders up 14.1% to $1,291 million

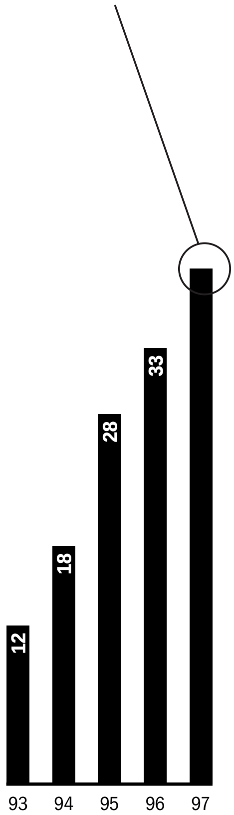
70.0c



Earnings

Earnings per ordinary share up 18.8% to 70.0 cents

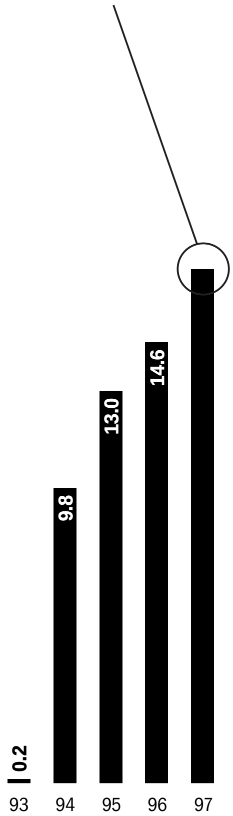
39c



Dividends

Dividends per ordinary share up 18.2% to 39 cents (fully franked)

17.0%



Return

Return on average ordinary equity increased to 17.0% from 14.6% in 1996

While proud of our unique heritage, we recognise that it does not guarantee ongoing success.

Competition is an inevitable part of life and some of the attributes that made us successful in the past may not be relevant for the future. To ensure Westpac makes the most of opportunities coming from these changing circumstances, we are actively pursuing improvements across our businesses to deliver innovative and cost-effective solutions to the financial needs of an increasingly sophisticated customer base.

In particular, we have continued a high level of investment in our businesses to build new earnings growth. These investments have centred on recent strategic acquisitions, on new technologies to give our customers better service, and on processing and support centres to make Westpac even more responsive and competitive in the future. Additionally, resources are being applied to address the 'millennium bug' issue, with completion planned for December 1998, at an estimated total cost of around $60 million.

Further progress was made this year in improving the mix and quality of our earnings. Our dependence on interest income has been reduced by increasing fee and other non-interest revenues. We have also enhanced the quality of our assets and have maintained tight expense controls while seeing staff productivity improve.

Westpac's progress in delivering steady and improving returns to shareholders has been due, in part, to our focus on investing in those lines of business which produce risk adjusted returns at or above our required return on capital. This strategy means that we are prepared to pass-up business opportunities where risk is being mispriced in the market, or where the returns do not match those our shareholders expect.

A further key to performance improvement has been Westpac's active capital and balance sheet management. Westpac continues to maintain a strong capital position, with a tier 1 capital ratio of 8% at year end. This figure is after allowing for the buy-back of 35 million shares in the year, and is well above the regulatory minimum requirement of 4%.

Securitisation has played a significant role in our active management of capital and the balance sheet. Securitisation involves selling loans to investors who assume the credit risk, thereby removing the assets from our balance sheet. The strategy works well because Westpac retains the customers and continues to service their needs. It allows us to alter the mix on the balance sheet away from lower return assets, to improve liability management by enhancing the liquidity of the balance sheet, and to use our capital more efficiently to deliver improved returns for shareholders.

A particular advantage of Westpac's strong capital position has been our ability to broaden our customer base through strategic mergers. The latest is the merger with Bank of Melbourne, which was approved by the Bank of Melbourne shareholders at the end of September 1997.

This follows the earlier mergers with Challenge Bank in Western Australia and Trust Bank New Zealand. Through these mergers we have welcomed two million new customers to the Westpac family in Australia and New Zealand. Importantly, we have endeavoured to retain the strong regional characteristics and service values of these banks, by operating the merged operations as Challenge Bank and Bank of Melbourne in their respective markets, and combining the banks in New Zealand under the new brand name of WestpacTrust.

The Challenge merger, completed in November 1996, resulted in a very positive outcome – Challenge was recently named Regional Bank of the Year, an excellent result from our first regional merger. This could not have been achieved without the support of our West Australian customers and the dedication of our West Australian staff. While the changes were initially somewhat disruptive for customers, they now have access to a better range of products and services than either bank was able to provide before the merger.

In looking to the future, it is clear that competition in all markets will remain intense. The Commonwealth Government's response to the Financial System Inquiry will add a further competitive dimension, as regulatory changes are developed and then implemented over the next two years. In such an atmosphere, we will continue our efforts to deliver better financial solutions to customers, to engage our staff to provide superior performance, and to support our many and varied communities as we seek to enhance Westpac's market position.

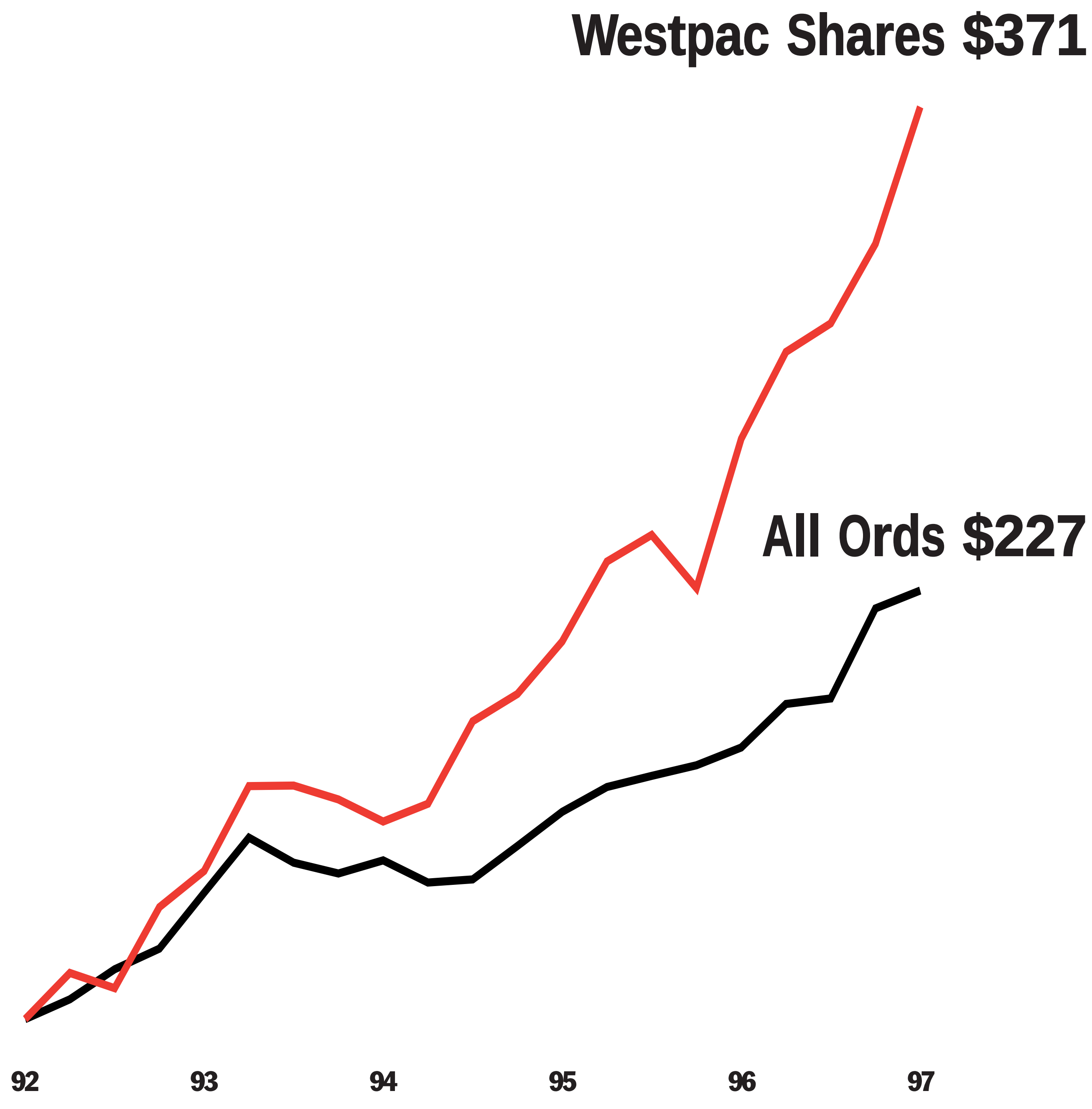
I recognise that our future performance is a matter of disciplined and skilful management. We have the management team and the strategies in place. Further performance improvements should come if we continue to actively manage our capital and balance sheet effectively, manage risk well, improve the efficiency of our operations, and meet our customers' expectations.

Our overall objective is to maximise shareholder value which will only be achieved if we satisfy customer needs and retain highly motivated staff.

Going forward, we will remain focused on pursuing sustainable, quality earnings growth. We will not seek asset growth simply to drive short term performance, particularly in competitive environments where risk may be underpriced.

In closing, I would like to thank our Board of Directors for their support and contribution and to thank Peter Baillieu, who retired as a Director following the 1997 Annual General Meeting, having served since 1974. The Board welcomes the appointment of Christopher Stewart and Helen Lynch as Directors. Both Mr Stewart, through his long association with the Bank of Melbourne, and Ms Lynch, through her earlier extensive career with Westpac, bring a wealth of experience in banking and corporate leadership which will be of considerable benefit to Westpac.

The Board also welcomes the appointment of Patrick Handley and David Morgan as executive Directors.



How your shares have performed One hundred dollars invested in Westpac on 30 September 1992 would have grown in value to $371 (assuming dividends were reinvested) as at 30 September 1997, which represents a compound annual return of 30.0%. The same investment in the All Ordinaries Accumulation Index would have grown to $227 representing a compound annual return of 17.9%

Thinking first about the customer in everything we do

Westpac has had a challenging, but positive year, as we continued to build the value of the company on behalf of our shareholders. This progress has been achieved largely through our staff's winning spirit and by staying focused on the foundation for success we set down for ourselves, namely, delivering better solutions for our customers.

We have actively sought to take advantage of the opportunities presented, while moving forward on our goal of being the bank of first choice for customers in each of our key markets and businesses.

In last year's report, I discussed our strategy of getting closer to our customers in our home markets of Australia, New Zealand and the Pacific Islands, and how we were concentrating on developing a more relevant and desirable product range to enhance our competitiveness. With distribution, I stressed how we were recognising the need to get products and services to our customers in faster and more innovative ways, no matter where, when or how they wished to bank. With infrastructure, I described how we were improving the efficiency of our front-of-house and behind-the-scenes operations. We knew that every action we took on these fronts needed to be done with customers' needs and the return on shareholders' equity as the driving forces.

Through the dedicated efforts of our staff, we now have a better platform for ongoing progress in each of these areas. We are beginning to see the real benefits from this consolidation and reinvestment phase, with the infrastructure in place to deliver lower costs and better products and services for our customers.

In the following pages we explain how we are building on these foundations to continue creating shareholder value across our businesses. Although each of our businesses provides discrete lines of products and services and pursues strategic goals aligned to the needs and potential of its own customer base, each is seeking to exceed the expectations of its customers in its own way. To illustrate this, we provide some tangible examples of our efforts as seen through our customers' eyes. We also share with you some of our progressive employee programs and our community activities that are essential features of our business plans.

Our vision

Our vision is simply to deliver better solutions for our customers. By doing so we aim to become the best banking group in our markets and hence the first bank in the minds of our customers.

Our ambition is to go well beyond our current position. Our initiatives, some of which are highlighted in this review, reflect this determination to realise our vision in each of our various businesses.

Customers, staff and the broader community have all played a key role in helping us shape our strategy of focusing on those markets that we know best and where we are able to develop a competitive advantage. Some commentators have questioned our approach when other banks are globalising and focusing on overseas markets. But history indicates that banks almost invariably do better when they build from strength in their home markets.

The key to effective banking is about getting close to your customers and understanding their financial needs, whether they be individuals, small businesses, corporations or institutions. As Australia's First Bank, our knowledge of, and affinity with, our Australian, New Zealand and near Pacific customers are our strengths. Our strategy is to capitalise on this competitive position.

As a result of this strategy, we have continued to be among the top providers in the institutional and international banking businesses. Through our customer-focused team approach, we have been able to further enhance our responsiveness in providing better corporate financing, financial markets, capital raising and transactional banking solutions to meet the needs of our corporate and institutional customers.

In consumer and business banking, our advantage continues to be our strong regional focus through locally managed operations, while having the strength of a major nation-wide bank. Having completed the integration of Challenge and Westpac in Western Australia, using the benefits of 'local touch backed by national strength', we are more convinced than ever that this is the way forward. The retention of customer business has exceeded expectations and the customer benefits flowing from the merger have been independently recognised with Challenge being named Regional Bank of the Year by *Personal Investment* magazine. We are now applying this valuable Challenge experience to our mergers with Trust Bank New Zealand and Bank of Melbourne in Victoria.

The growing partnership between both Westpac Financial Services (WFS) and Australian Guarantee Corporation (AGC) and the banking operations, is a further important component in this delivery of a better, total solution to our customers' financial needs. There is clearly a major opportunity to enhance relationships with our over seven million customers, by more actively introducing them to the extensive range of insurance, investment, superannuation, leasing and financing services provided by WFS and AGC.

"Providing effective infrastructure support allows our staff to respond more quickly and deliver quality solutions."

In support of our vision, we have also continued to make considerable investment in technology and infrastructure to deliver better customer service. We want our staff to have the right training and tools to support them.

This year we completed our program of installing a new service platform into branches, deploying the latest PC technologies developed in partnership with Microsoft. In identifying Westpac as a world-class example of how Microsoft technology can deliver significant benefit at very low costs, Microsoft has stated that Westpac's technology developments have "provided a flexible environment to deliver continuing improvements in customer service, yet achieved what we believe to be the world's lowest total cost of ownership". Now, all branch staff are equipped to provide more professional customer service and respond more quickly to future business and market needs, including new products and legislative changes.

Within our institutional banking business, financial markets operations have been streamlined around the world by centralising transaction processing and accounting. This has freed-up local management to concentrate on sales and marketing, improved operational risk control, and provided around $35 million in annual savings.

A further example of our value adding investment in infrastructure is the consolidation and restructure of our New South Wales processing operations. The $50 million purpose-built centre, located outside Sydney's central business district, will house 1,000 employees and provide staff facilities including an on-site childcare centre. This investment reflects our strong commitment to creating better workplaces, and enables us to cost-effectively integrate a number of business functions.

The centralisation of our home-loan business at the Adelaide-based Mortgage Processing Centre (MPC), which was discussed in last year's report, has provided a visible example of adding value by changing the way we do business. Although we initially encountered some teething problems in transforming the way we originate and service our flow of more than 5,000 new loans per month, the level of customer service now being provided by our MPC staff represents an increasing competitive advantage.

Westpac's future will bring more challenge and change as the Commonwealth Government progressively implements its response to the Financial System Inquiry Report over the next two years. Our response will be to get even closer to our customers and to deliver better solutions to their financial needs.

"We know we are working in a time of unparalleled change. But change also brings opportunity, particularly for institutions that have the flexibility to adapt and the ambition to stay ahead of the game."

We recognise we still have a way to go to reach our goal of being the best bank in our chosen markets, but that is the vision that keeps us challenged.

Consumer banking

In consumer banking we have kept our eye firmly on the ball by putting our customers first, and being responsive to their changing needs.

During the past year, consumer banking in Australia became even more competitive with housing margins falling to historic lows. Competition for the savings dollar also remained intense from other deposit takers and fund managers, as consumers have sought to maximise their risk-adjusted returns in this low interest rate environment. In addition, the rapid development of banking technology in the consumer area has given customers an unprecedented range of products, as well as choices, for accessing banking services. With Westpac's increased scale in the key Australian markets following the recent mergers, we are in an improved position to meet the challenges.

Westpac's response is to concentrate on delivering better solutions by getting closer to our customers through our regionalisation initiatives, and by developing innovative, attractive products. In addition, in a service business such as banking where our competitive edge can only be achieved through effectively responding to our customers, we recognise that an important ingredient for success is constantly improving teamwork within businesses and across business lines.

One example of responding to customers is Australia's 'Mortgage of the Year', our First Option Home Loan. We have enhanced this low-cost, basic home loan by giving customers a redraw facility and the option to add more features on a 'pay only as you use' basis. Home loan customers have also benefited from our standard variable housing interest rates falling by 3.71 percentage points since July 1996, some 1.21 percentage points more than the reduction in official interest rates.

Another example is the Retirement Saver account, an over-the-counter superannuation product which acts like a bank deposit account. This is retailed through our branch network and was developed in partnership with WFS.

In support of our customer-first strategy, we appointed Campaign Palace to strengthen our branding and, through our advertising, more clearly communicate the benefits of banking with the Westpac family. We have also put in place enhanced processes and strategic partnerships in the direct marketing area to improve targeted customer communication and marketing.

Another very visible area has been our card products. Through our participation with Visa and Ansett, partners in sponsoring the 2000 Olympic Games, the Global Rewards Westpac Visa card was launched in February 1997 and more than 100,000 cards had been issued by the end of September 1997. A significant portion of these customers are new to Westpac, representing potential relationship-building opportunities. The card allows customers to earn frequent flyer points and also helps the Australian Olympic Team through a $10 contribution from the annual card fee.

A further example of our customer first strategy is Westpac's private banking service, which focuses on high net-worth individuals in Australia. While private banking has enjoyed considerable growth through the year, our ongoing success depends on maintaining the highest quality customer service. To achieve this, we have a team of highly skilled relationship managers available 24 hours a day, seven days a week, or customers can choose the convenience of a new telephone banking service. During the year, new products were also introduced for this discrete market, including the Protected Investment Loan and Line of Credit. Survey results indicate high levels of private banking client satisfaction and support.

Throughout the year, Westpac's efforts have been recognised in industry awards covering home mortgages, personal loans, savings accounts, credit cards and regional banking. The recognition lets us know that our strategic approach of continuing to develop better products and putting our customers first is on the right track.

Recognising that transaction banking is the core of our consumer customers' relationship with us, we have continued to improve access and convenience for them. Westpac customers now access their accounts through more than 6,000 ATMs across Australia, which is close to 85% of all ATMs in the country. Customers also make nearly 35 million calls each year to our market-leading telephone banking service, with around 85% of these calls using the automated voice response facility. Not only has this provided a level of customer satisfaction well beyond that normally seen in any service industry, it has resulted in the telephone banking service being at world's best practice in terms of cost per call. Easy access to an open and user-friendly, multi-channel distribution system, that allows customers maximum choice, is increasingly important as work and leisure patterns change.

Sound progress has been made towards building the consumer bank of first choice in Australia, but our task is by no means complete. The challenge is to continue to build on this progress.

Business banking

Our approach to business banking is firmly focused on understanding our different customer segments and responding effectively with speed and consistency, to be the winning-edge service provider.

In the business banking market, Westpac recognises that the needs of businesses vary depending on their size, their time in operation and their industry. Consequently, our product delivery, sales and services to each segment differ, but are built around the common theme of timeliness, speed and consistency.

With our smaller business customers, we are striving to enhance our delivery by giving operators simple, convenient and timely services at low cost. For more substantial small businesses, we are expanding our professional relationship management, and for larger medium-sized businesses, we are aiming to provide highly qualified, dedicated relationship managers working in long term partnership with clients, to provide customised and innovative solutions to their more complex financial needs.

On the product side, we are seeking to be more responsive and understanding of customer needs. Westpac was the first bank to respond to the fact that many business customers today are seeking a complete financial package, incorporating a line of credit using the equity in a residential property. The result was the Business Equity Line of Credit which has had a positive customer response and received industry recognition. We also introduced the reduced rate Mortgage-Free Business Finance Loan, designed for those many small business owners who do not want to use their family home as security. A further example is Business Express Deposit, which allows a business to save valuable time by depositing their daily takings in special, tamper-proof security envelopes.

We have also sought to be responsive in passing efficiency and competitive benefits to customers, as illustrated by the reduction in overdraft rates by up to 4 percentage points, well beyond the 2.5 percentage points fall in official interest rates since mid-1996.

This has provided our all important small- to medium-sized business customers with interest savings they can use to boost growth and investment in their businesses. Our business customers have also responded positively to initiatives to improve ease of access. Business DeskBank, launched this year, allows customers to process their payroll and creditor payments through their office personal computers. This product is helping small businesses manage their finances time-efficiently and at a lower cost, and is helping us achieve our goal of being the winning-edge service provider. This complements our telephone banking services which continue to grow, with nearly 80% of our business customers now subscribing. We handle more than 150,000 calls each month, with business customers transacting $150 million via phone each month. A customer satisfaction survey of more than 17,000 customers resulted in a 90% approval for our telephone banking services. As a result of these initiatives, Westpac continues to have the highest proportion of business customers using electronic and telephone banking.

We have always recognised that agricultural business customers have different needs from most urban businesses, which is the reason for increasing our national team of experienced rural mobile managers. The enhancements through the year in our personal approach to agricultural customers continues a proud heritage of commitment to the agribusiness market.

Westpac also continued to build on its commitment to women in business in 1997. Results have been encouraging, with a number of dedicated managers being appointed around the country to meet the specific needs of women in business. Westpac has also become a major sponsor of the Australian Council of Businesswomen, to assist in gaining better understanding of this important segment.

Financial services

The growth in our financial services businesses over the year indicates that our investment in providing a total financial solution for the investment and insurance needs of customers is paying off.

Westpac continued to build its financial services businesses throughout 1997, to capitalise on the regional banking strategy and the changing patterns of savings and investment behaviours within the community.

New product and sales opportunities arose as the community showed an increasing appetite for managed investments and insurance packages, and a desire to optimise investment returns in the current low interest rate and inflation environment.

As part of our strategy to be able to offer a complete financial services package to our customers, Westpac acquired AMPAC Life Limited (now renamed Westpac Life Insurance Services) from the AMP Society at a cost of $343 million in October last year. Our ability to bring together the design, distribution and marketing of life products has improved WFS' responsiveness in delivering better solutions for our customers' insurance needs.

An outstanding example of developing products with the flexibility to meet customers' needs is the Westpac Personal Portfolio Service (WPPS), Australia's number one selling investment product, which now has more than $1.2 billion in funds under management. The WPPS has no up-front fees and allows customers a choice of specific sector investments of balanced funds managed by Westpac, or a representative list of external fund managers. During the year, the Westpac Personal Investment Fund also grew to more than $1 billion in funds under management. Customers also responded to more active marketing of general insurance, with 1997 premiums at a record $124.4 million.

These successes have contributed to a 50% increase in sales in the year, with funds under management growing to more than $15 billion, a growth of 48%. With more than 550,000 customers, WFS is now the fifth largest retail funds manager in Australia and is ranked number three in net new retail funds inflow (excluding cash trusts). In fact, Westpac had three of the 10 fastest growing retail funds in Australia in 1997. Strong investment performance also saw Westpac rank in the top half of fund managers for the year to September 1997. In the custody business, assets under custody have increased by 39% to more than $87 billion, continuing our position as the market leader in Australian domestic custody.

On top of strong growth within the existing customer base, the recent merger with Challenge Bank is assisting sales as newly acquired customers are introduced to WFS' comprehensive range of investment, superannuation and insurance products. We are anticipating a similar interest from Bank of Melbourne customers.

Institutional banking

We are a leading player in institutional banking through our ability to create business solutions that make sense for our customers.

Finding effective solutions to our institutional clients' banking and finance needs, while ensuring we generate strong shareholder value, is our driving force. To improve the return to shareholders while continuing to meet the needs of customers, we are increasing the focus on less capital-intensive activities such as arranging and managing debt issues, arranging loan syndications and providing advice to our corporate and institutional customers.

Westpac's intimate understanding of the changing needs of Australasian customers, both domestically and internationally, enables us to enhance our position as a leading player in institutional banking, with products and services that are recognised as amongst the best in their markets. Based upon third party surveys of the top 500 Australian corporations, Westpac is the principal corporate banker to 27% of Australian corporations and principal transactional banker for 33% of this market with a significant market share advantage over the nearest rival. These surveys also found that Westpac consistently has the highest customer satisfaction rating of the major Australian banks.

To maintain this strong market position, we continue to invest in what we see as our key service differentiators: strength of customer relationships, contact frequency, loyalty and teamwork. This investment is supporting high quality customer service. In the delivery of capital markets services, research from surveys of top companies, institutions and government bodies, compiled by the Financial Products Research Group, ranked Westpac number one in market recognition and penetration in Australian capital markets for the second year in a row.

Other independent research ranked Westpac as the top debt arranger for Australian syndicated corporate loans for the second consecutive year, and the top lead manager of domestic corporate and mortgage backed bonds. These results further underscore the benefits of debt origination, distribution and relationship managers all working together as a team.

Our financial markets activities provide another example of our ability to deliver quality service. Westpac has frequently ranked first in market surveys of Australian dollar foreign exchange and interest rate risk management, and New Zealand dollar foreign exchange. We continue to pursue initiatives to enhance our effectiveness, such as the centralisation of market risk management, processing and accounting.

The pan-Asian strategic relationship developed this year with Standard Chartered Bank (SCB) is another example of how Westpac is delivering creative business solutions that make sense for both customers and shareholders. This relationship with SCB magnifies Westpac's Asian capabilities far beyond those of our domestic competitors, providing a broad physical presence in 21 Asian countries through some 255 points of representation for Westpac's Australasian based customers.

The unique interlinking of Westpac's and SCB's systems and capabilities, combined with SCB's extensive Asian network, is proving attractive to our institutional banking customers and clearly differentiates us from our competitors. For instance, through Westpac's DeskBank system, customers can operate and electronically access accounts with SCB branches in Asia from Australia. The relationship allows customers to arrange local currency borrowing in Thailand, Malaysia and Singapore, where such activity is otherwise restricted.

This strategic relationship is complemented by our Asian business unit in Australia, and our sponsorship of *Asialine*, a Commonwealth Department of Foreign Affairs and Trade publication targeting Australian companies seeking to conduct business in South and South-East Asia. Westpac is also actively involved in the Investment 2000 initiative to facilitate direct foreign investment into Australia.

Westpac's overall ability to adapt to the changing Australasian markets and provide innovative solutions has been recognised by corporate treasurers and institutional investors in polls conducted by *Finance Asia* magazine, with Westpac recognised as being the best bank in the Australasian corporate and institutional market.

Pacific Islands region

Our long history in the Pacific has given us an insight into providing a competitive edge in the way we service our Pacific markets.

Our longevity has helped us develop an innate understanding of our Pacific customers, many of whom have requirements which are unique to their island nations. Customer knowledge is of particular importance in these markets given the variety of environments in which we operate. This variety places special demands on the skills and knowledge of our people.

The economic challenges confronting the regional governments over the past few years present both challenges and opportunities for Westpac's Pacific businesses. We have remained focused on sustainable, quality earnings growth in this environment and maintained solid returns on behalf of shareholders, while enhancing our transactional services, product offerings and efficiency.

In particular, we are pursuing synergies across the Group by helping Pacific customers conduct business within Australasia and Asia, including introducing high-net worth customers to Australian-based private banking, and developing global customer management for institutional customers operating in the region.

We continue to invest in skills, knowledge and technology in the region, while developing our local capacity to better serve our customers. This includes further expansion of the EFTPOS networks recently introduced into the Papua New Guinea and Fiji markets.

Westpac's ongoing strategic focus is to improve the overall mix of risk, while diversifying and shaping our Pacific businesses to provide the best returns to shareholders.

New Zealand

The strength of WestpacTrust lies in its 136 years of experience in meeting the banking needs of New Zealanders and its involvement in the community.

As New Zealand's largest bank, with some NZ$26 billion of assets, 1.3 million customers, and a market share of close to 22% in core deposits and loans, WestpacTrust has the advantages of size and scale and the unique opportunity to build an even better bank as we merge the Trust Bank and Westpac operations.

The most visible sign has been the launching of our new brand, WestpacTrust – a brand that has customer focus at its core. It is a powerful entity that draws on Trust Bank's and Westpac's proud records of customer commitment in New Zealand spanning some 136 years.

The biggest challenge is to maintain the quality of service for customers as the banks are brought together. The process of merging the banks was approximately at the half way point at September 1997, with the head offices combined, new regional management and advisory boards in place, an enhanced sales and service structure established, and the alignment of the products of the two banks to the new WestpacTrust product suite nearly complete. Already, the credit card systems have been fully merged and customers are receiving card statements under the WestpacTrust label.

Teamwork between the staff of both organisations is essential as we capture and build on the strengths of both banks. Our customers are directly experiencing the results of this teamwork, as 50% of the branches are already operating in shared locations prior to full merger of systems and branches. To ensure we do not lose sight of the things that have made each bank unique in their customers' eyes, most of our branch staff will spend a period working in the other bank's branches to experience and understand the systems and culture of each bank. This is one of the many activities we are undertaking to make sure that the changes for our customers and staff are as positive as they can possibly be.

Recognising that we live in an electronic age, WestpacTrust has continued to work on ways to improve the ease of access for customers and the cost efficiency of our service delivery. One of the advantages of bringing together the two banks' operations, is that it provides further opportunities to develop alternate distribution systems in response to the trend away from branches, including enhancing our telephone banking services, ATM and EFTPOS networks.

WestpacTrust is committed to maintaining close links to local communities as we build our business. Being a valued part of customers' lives through our banking and financial services and community activities is an integral part of achieving our ambition to be a financial services leader, and a great New Zealand company.

AGC

Australian Guarantee Corporation's strength remains its ability to understand its markets and adapt and respond creatively to changing customer needs.

The markets in which AGC competes are as intense as any other in the financial services arena. Despite this, AGC has had an outstanding year in new business activity. It has responded to the challenges coming from existing players looking to expand and diversify, and from new players using price or risk absorption as competitive weapons. Motor vehicle manufacturers as well as the finance arms of other major banks have been active in that market, while regional and major banks, as well as building societies, are expanding their roles in the equipment finance market. New players in the shape of factory financiers, capital financiers, equipment vendors, self-financing introducers and originators have also entered the market.

AGC has developed creative ways to give customers more responsive products and services while ensuring we achieve the best financial return for our shareholders. One area where AGC has had marked success in responding creatively is through the growth in the AGC-branded MasterCard, currently running at 50,000 active accounts. Customer loyalty is also being rewarded by providing special interest rate premiums for AGC debentures, while new products for small- to medium-sized businesses, including Insurance Premium Finance and Guaranteed Residual Asset Purchase financing, have been developed.

This success has resulted in AGC maintaining its significant share of finance company business in Australia and New Zealand, while actively pursuing growth opportunities. Capital equipment financing grew strongly, assisted by an agreement with Telstra to refer their rental customers to AGC/Westpac as their preferred finance provider for certain equipment rentals. AGC's strong position in the auto finance segment was also maintained. In consumer lending, business grew significantly through relationships developed with merchants of whitegoods, electronic and personal computer equipment, who originate point-of-sale AGC finance for their customers.

Another of AGC's strengths is its ability to work in harmony with, and draw on, the broader customer and resource base of the Westpac family. This involves maximising the overall value of the Westpac product family for the customer, by introducing such AGC products as leasing finance and factoring. This deepening of cross-boundary relationships using credit, marketing and customer management skills builds more valuable and stable customer relationships for the Group.

Our people

We know we can only deliver better solutions to our customers if we gain a performance edge through our people.

None of the programs and strategies we have outlined could have succeeded without the efforts of Westpac's 32,000 staff around the world. These are the men and women whose resourcefulness and energy restored the credibility and financial health of Westpac following the asset quality and performance problems of the early 1990s. This same energy is now focused on building a great company. Their experience, integrity and pride in Westpac, and in their jobs, are driving the improvement in returns for shareholders.

To deliver better customer solutions, it is essential we continue to invest in management capability and nurture our overall portfolio of talent. Our approach is two-pronged. First, encouraging staff to take control of their own careers, so that staff can direct their own career paths and ensure Westpac gets the best person for the job. Second, supporting these initiatives through manager coaching, skills development and training, and flexible working conditions, to help balance work and home responsibilities. However, while we promote choice in career streams, we consistently reinforce that superior performance is the deciding factor in career advancement.

Our commitment to staff development also extends beyond the workplace. We care about our staff as individuals and recognise they have pressures outside the workplace which can impact on their performance. To provide tangible support, we have developed a range of programs to help them and their families.

The Employee Assistance Foundation aids staff (and their families) who, through circumstances outside their control, find themselves in financial hardship. Westpac is the first bank to introduce a foundation of this kind. Staff, and their immediate families, can seek confidential and professional help through Westpac's ACCESS program via Australia-wide, toll-free telephone counselling. Launched in January 1997, staff can also seek help through Family Carelink in making care arrangements for their dependants. In addition to six weeks' paid maternity leave introduced last year, Westpac initiated paid adoption leave in March 1997.

Westpac's initiatives for staff have been recognised in the 1997 Australian Financial Review/Business Council of Australia, Corporate Work and Family Awards. The award, which was the highest given in the financial services category, recognised Westpac's demonstrated commitment to continuously improving and promoting work and family policies throughout the organisation.

Because we are committed to serving the diverse needs of our broad customer base, Westpac actively seeks diversity in its workforce regardless of race, gender, creed or disability. This commitment to workforce diversity ensures that our workforce demographic reflects that of our broad customer base and helps us to stay focused on finding better solutions to meet their differing needs.

We also believe that one of the best ways to promote shareholder value as a driving force for our staff is to give them an opportunity to share in Westpac's profit by encouraging them to become shareholders themselves. Each year we offer participating staff a choice of shares through the Westpac Employee Share Plan or a lesser cash bonus, with the number of shares or cash offered being based on the degree to which Westpac's full year performance exceeds a predetermined target return.

Our community

Forging links with and becoming involved as an active member of our community is vitally important to Westpac.

We encourage and support our people to forge links with their communities. Westpac is also a major financial contributor and provides extensive in-kind support to a wide range of community projects and activities.

At least one third of our staff gave their time as community volunteers supporting projects such as Clean Up Australia Day, The Salvation Army Red Shield Appeal, Young Achievement Australia, Walk for the Cure (for juvenile diabetes) and many more.

While our community sponsorships are important, our extensive range of in-kind support touches a wide cross section of the community and provides significant and lasting benefit. Assistance with fundraising through our branches, providing financial management expertise to non-profit organisations, serving on the committees of community organisations, providing volunteers for community activities and working with the Australian Pensioners' and Superannuants' Federation to educate older people about changes in banking are all examples of how Westpac makes a difference at a local level.

Our community development and sponsorship activities are managed by regional executives who are close to their communities and know best how to assist and make a difference. On a regional basis, we initiated a number of sponsorships reflecting the needs and interests of our staff in those communities. These include our New South Wales and Victorian staffs' commitment through payroll deductions to United Way which Westpac matches dollar-for-dollar, and Challenge Bank's partnership with the Western Australian Sports Centre Trust highlighted by its sponsorship of the Challenge Stadium.This year Westpac launched Community 2000, a staff volunteering program which sees thousands of Westpac staff involved in their local communities. To encourage and support this effort, we introduced a community service day to enable staff to have paid time off work for volunteering activities.

Our staff's commitment is recognised in a practical way through the Managing Director's Community Service Awards. Each year, staff are nominated by their colleagues for their volunteering efforts. The winners are recognised by Westpac making a donation to the community organisation which has been receiving their volunteer services. Since the introduction of the awards in 1993, more than $300,000 has been provided to community groups and needy causes across Australia, New Zealand, Papua New Guinea and the Pacific Islands.

Westpac has been a major sponsor of Clean Up Australia since its inception in 1989, joining with the more than three million Australians who have rolled up their sleeves to help clean up our country. As principal sponsor, we are a driving force of the Clean Up 2001 initiative to complete 2001 community environmental projects throughout Australia by the year 2001. But our environmental commitment goes beyond our shores. Westpac is the only Australian bank to have endorsed the United Nations' Environment Program Statement. We are also the first non-industrial company to sign up with the Commonwealth Government's Greenhouse Challenge initiative, involving energy efficiency practices and paper recycling programs.

Our 24-year, high-profile commitment to the Surf Lifesaving Association Rescue Helicopter Service in Australia is our most established sponsorship. The service has expanded to now provide search and rescue, medical care at accidents, and patient transfers along the entire east coast of New South Wales, and the Gold Coast and Sunshine Coast in Queensland.

In New Zealand, WestpacTrust renewed our commitment to the four helicopter rescue services in Auckland, Hamilton, Wellington and Christchurch, and to our numerous community sponsorships covering chamber music, beef open days, rugby, basketball and business excellence awards, just to name a few. WestpacTrust is also helping Team New Zealand defend the America's Cup by involvement in the official sponsors' program.

At Westpac, we recognise the added value that can come from being involved with community issues and, as such, are participating in a variety of programs which support, encourage and develop women in business. Through our sponsorship of the Australian Council of Businesswomen we have participated in a series of forums to gather the thoughts, opinions and ideas of women from diverse backgrounds, in order to influence public policy and debate on issues affecting women. Westpac was the only Australian bank invited to attend this year's OECD conference in Paris on 'Women Entrepreneurs', where both Westpac's and the Australian Council of Businesswomen's work was acknowledged as first class. We are also involved in the Women of the Land gatherings, various seminar programs and sponsoring the women-in-business mentoring programs.

Our major new activity this year is our commitment to the Sydney 2000 Olympic Games. In addition to being a Sydney 2000 Olympic Games Team Millennium Partner, we are the Official Bank of the 2000 Olympic Games and of the Australian Olympic Team. Our involvement is far-reaching. We are supporting the Olympic Job Opportunities Program and the Paralympic Employment Program and currently employing 23 athletes under the programs.

We are also involved in a range of initiatives that encourage staff participation and enhance our relationship with the community and our customers. Westpac has been proud to be a Presenting Partner of The Olympic Journey – a series of parades, picnics and exhibitions which have taken the spirit of the Olympic Games to more than a quarter of a million Australians throughout the length and breadth of the nation and have actively involved customers and staff. By the end of 1997, our Reserved Seating Program will also see 180 customers win packages for two to attend the Sydney 2000 Olympic Games as part of our marketing and customer loyalty initiatives. These initiatives and activities will ensure that our investment generates a return for staff, customers and shareholders.

As Australia's First Bank, we are confident that the business, employee and community initiatives underway, as highlighted in this review, will move us towards our goal of being the bank of first choice in each of our various businesses.

Financial review

Ten year summary

$m (unless otherwise indicated)	**1997**	1996	1995	1994	1993
Profit and loss – year ended 30 September[1]					
Net interest income	**3,353**	3,254	2,982	2,761	2,628
Non-interest income	**1,739**	1,472	1,391	1,555	1,841
Operating income	**5,092**	4,726	4,373	4,316	4,469
Provisions for bad and doubtful debts	**(78)**	(121)	(330)	(695)	(1,292)
Total operating income net of provisions for bad and doubtful debts	**5,014**	4,605	4,043	3,621	3,177
Non-interest expenses	**(3,228)**	(3,049)	(2,654)	(2,637)	(2,629)
Operating profit/(loss) before income tax and abnormal items	**1,786**	1,556	1,389	984	548
Income tax (expense)/credit	**(493)**	(421)	(371)	(276)	(146)
Abnormal items (net of tax)	**–**	–	(68)	–	(358)
Outside equity interests	**(2)**	(3)	(3)	(3)	(5)
Operating profit/(loss) after income tax attributable to shareholders	**1,291**	1,132	947	705	39
Balance sheet at 30 September[1]					
Total assets	**118,963**	121,513	105,835	93,861	104,712
Loans	**77,874**	81,201	64,365	61,242	64,601
Acceptances	**11,242**	11,197	11,656	12,219	12,851
Deposits and public borrowings	**72,636**	74,886	58,198	54,925	57,669
Loan capital	**1,895**	2,199	2,881	2,929	3,333
Shareholders' equity (incl. outside equity interest)	**8,206**	7,891	7,583	7,299	7,129
Total risk adjusted assets	**87,133**	86,503	74,930	72,567	82,777
Share information					
Earnings per share (cents)					
Before abnormals	**70.0**	58.9	53.5	36.0	21.1
After abnormals	**70.0**	58.9	49.8	36.0	0.9
Dividends per ordinary share (cents)	**39.0**	33.0	28.0	18.0	12.0
Net tangible assets per ordinary share ($)[2]	**3.69**	3.39	3.81	3.67	3.51
Share price ($)					
High	**9.10**	6.59	5.51	5.55	4.20
Low	**6.43**	5.20	3.90	3.83	2.39
Close	**8.70**	6.54	5.36	4.20	3.94
Ratios					
Shareholders' equity to total assets (%)	**6.9**	6.5	7.2	7.8	6.8
Risk adjusted capital ratio (%)	**10.5**	10.8	13.9	13.8	12.3
Dividend payout ratio (%)	**55.3**	55.3	56.3	50.3	large
Return on:					
Ordinary shareholders' equity – average (%)[3]	**17.0**	14.6	13.0	9.8	0.2
Total assets – average (%)	**1.03**	0.97	0.97	0.71	0.04
Productivity ratio[4]	**2.90**	2.73	n/a	n/a	n/a
Expense to income ratio (%)[5]	**63.4**	64.5	60.5	59.6	65.5
Net interest margin (%)	**3.6**	3.7	3.8	3.5	3.0
Other information					
Points of bank representation (number at period end)	**1,547**	1,788	1,547	1,616	1,827
Full time equivalent staff (number at period end)[6]	**31,608**	33,832	31,416	31,396	33,724

1 The above profit and loss extracts for 1995, 1996 and 1997 and balance sheet extracts for 1996 and 1997 are derived from the consolidated financial statements included in this report, and for prior years are derived from consolidated financial statements previously published.

2 After deducting preference share capital and intangible assets.

3 Figures for 1988 have been adjusted for the inclusion in reserves of the property revaluation surplus.

Ten year summary (continued)

$m (unless otherwise indicated)	1992	1991	1990	1989	1988
Profit and loss – year ended 30 September[1]					
Net interest income	2,592	2,874	3,160	2,873	2,619
Non-interest income	1,756	1,743	1,681	1,570	1,273
Operating income	4,348	4,617	4,841	4,443	3,892
Provisions for bad and doubtful debts	(2,802)	(1,119)	(1,192)	(579)	(275)
Total operating income net of provisions for bad and doubtful debts	1,546	3,498	3,649	3,864	3,617
Non-interest expenses	(3,169)	(3,070)	(3,060)	(2,781)	(2,486)
Operating profit/(loss) before income tax and abnormal items	(1,623)	428	589	1,083	1,131
Income tax (expense)/credit	548	(105)	(109)	(283)	(520)
Abnormal items (net of tax)	(485)	150	198	–	94
Outside equity interests	(2)	3	6	1	(12)
Operating profit/(loss) after income tax attributable to shareholders	(1,562)	476	684	801	693
Balance sheet at 30 September[1]					
Total assets	110,948	106,019	106,991	108,619	84,579
Loans	66,348	63,838	65,922	61,723	48,446
Acceptances	11,166	12,357	12,946	10,546	7,858
Deposits and public borrowings	60,261	60,280	62,547	62,932	48,129
Loan capital	3,261	2,611	2,628	2,684	2,091
Shareholders' equity (incl. outside equity interest)	6,676	7,245	6,871	6,355	5,499
Total risk adjusted assets	94,904	92,322	95,401	93,376	80,289
Share information					
Earnings per share (cents)					
Before abnormals	–	26.6	43.3	79.4	83.8
After abnormals	–	39.5	61.5	79.4	94.0
Dividends per ordinary share (cents)	18.0	27.5	52.5	52.5	43.0
Net tangible assets per ordinary share ($)[2]	3.56	5.66	5.80	5.87	5.58
Share price ($)					
High	5.05	4.92	6.12	6.14	6.12
Low	2.73	3.16	4.00	4.60	3.22
Close	2.85	4.47	4.09	5.54	6.00
Ratios					
Shareholders' equity to total assets (%)	6.0	6.8	6.4	5.8	6.5
Risk adjusted capital ratio (%)	9.7	10.4	9.5	9.4	9.4
Dividend payout ratio (%)	–	71.5	87.2	68.1	48.1
Return on:					
Ordinary shareholders' equity – average (%)[3]	–	6.6	10.1	13.4	15.6
Total assets – average (%)	–	0.43	0.62	0.81	0.87
Productivity ratio[4]	n/a	n/a	n/a	n/a	n/a
Expense to income ratio (%)[5]	69.1	66.5	63.2	62.5	63.8
Net interest margin (%)	2.9	3.4	3.7	3.8	4.4
Other information					
Points of bank representation (number at period end)	1,946	1,968	1,987	1,955	1,949
Full time equivalent staff (number at period end)[6]	39,253	42,431	45,395	45,383	44,250

4 Operating income/personnel costs excluding restructuring expenses.

5 Excludes superannuation adjustment and in 1992, Network Ten.

6 Full time equivalent staff includes pro-rata part time staff and excludes unpaid absences (e.g. maternity leave).

The financial review is based on Westpac's consolidated financial statements, prepared in accordance with Generally Accepted Accounting Principles applicable in Australia (Australian GAAP). The significant differences between Australian GAAP and US GAAP are discussed in note 40 of the notes to the financial statements, which also includes reconciliations for operating profit (net income) and shareholders' equity. This review is for years ended 30 September 1997, 1996 and 1995.

Overview of performance

SUMMARY CONSOLIDATED PROFIT AND LOSS STATEMENT

	1997 $m	1996 $m	1995 $m
Net interest income	**3,353**	3,254	2,982
Non-interest income	**1,739**	1,472	1,391
Operating income	**5,092**	4,726	4,373
Provisions for bad and doubtful debts	**(78)**	(121)	(330)
	5,014	4,605	4,043
Non-interest expenses	**(3,228)**	(3,049)	(2,654)
	1,786	1,556	1,389
Income tax expense	**(493)**	(421)	(371)
Outside equity interests	**(2)**	(3)	(3)
Operating profit after income tax before abnormals	**1,291**	1,132	1,015
Abnormal items net of income tax	**–**	–	(68)
Operating profit after income tax attributable to shareholders	**1,291**	1,132	947
Earnings per share (cents)			
Basic	**70.0**	58.9	49.8
Fully diluted	**67.8**	57.1	48.1

Westpac Banking Corporation's consolidated after tax profit attributable to shareholders was $1,291 million for the full year ended 30 September 1997, a 14.1% increase over the $1,132 million earned in the 1996 financial year, which, in turn, was 19.5% higher than the profit of $947 million recorded in 1995.

Earnings per ordinary share were 70.0 cents, an increase of 18.8% over the 58.9 cents earned in the full year to 30 September 1996, which was an increase of 18.3% over the 49.8 cents earned in 1995. Return on average ordinary equity increased to 17.0% from 14.6% in 1996 and 13.0% in 1995.

Net interest income was $3,353 million in 1997, up from $3,254 million in 1996, in an increasingly competitive environment across all businesses in Australia and New Zealand. Westpac Group's net interest margin was 3.6% for 1997, down slightly from 3.7% for 1996 and 3.8% for 1995.

Non-interest income increased by 18.1% to $1,739 million in 1997 from $1,472 million in 1996, due to growth in financial services revenues, fees, commissions, financial markets and other non-interest income, as well as the full year impact of Trust Bank New Zealand.

The bad and doubtful debt charge of $78 million or 2.3% of net interest income, was down on the $121 million or 3.7% of net interest income for the 1996 year, reflecting improved asset quality. The 1996 charge was down 63.3% on the 1995 charge of $330 million. Total provisions for bad and doubtful debts decreased by $259 million to $1,588 million in 1997, or 1.8% of total loans and acceptances (down from 2.0% at the end of 1996). Total provisions now represent 184.2% of total impaired loans (145.1% at year end 1996), reflecting the improvement in asset quality.

Non-interest expenses grew by 5.9% in 1997, reflecting the full year impact of the Challenge Bank and Trust Bank New Zealand mergers. Adjusted for the impacts of the mergers and for restructuring expenses in 1996, non-interest expenses remained flat.

Total assets decreased by 2.1% during the year, largely reflecting the impact of securitisation and asset sales, as well as the reduction in prime asset requirements by the Reserve Bank of Australia (RBA). As a result of securitisation and asset sales, net loans decreased by 4.1%. Return on average assets increased to 1.03% from 0.97% in 1996.

The tier 1 capital ratio was 8.0% at year end, after allowing for the impact of the buy-back of 35 million shares in 1997. The total capital ratio of 10.5% remains well above the regulatory minimum requirement of 8.0%. Total ordinary equity to total tangible assets stood at 5.6% at year end, up from 5.1% in 1996.

Profit and loss review

The 1997 result was driven by a strong focus on costs, enhancement of non-interest revenues, careful attention to asset quality, and active balance sheet and capital management. In the falling interest rate environment, with historically low interest rates, and near the bottom of the credit loss cycle, emphasis was on maintaining risk adjusted returns, rather than seeking to maintain interest income primarily through organic asset growth.

Net interest income

Net interest income increased by $99 million, or 3.0% to $3,353 million in 1997, and by $272 million, or 9.1% to $3,254 million in 1996.

INTEREST SPREAD AND MARGIN ANALYSIS

	1997 $m	1996 $m	1995 $m
Adjusted net interest income[4]	**3,480**	3,322	3,026
Average interest earning assets	**96,827**	89,332	78,512
Average non-accrual loans	**852**	1,584	2,430
Average interest bearing liabilities	**85,415**	77,504	65,771
Average net non-interest bearing and equity	**11,412**	11,828	12,741
Group			
Interest spread on productive assets[2]	**2.9%**	2.9%	3.0%
Impact of impaired loans	**–**	(0.1)%	(0.2)%
Interest spread[1]	**2.9%**	2.8%	2.8%
Benefit of net non-interest bearing liabilities and equity[3]	**0.7%**	0.9%	1.0%
Interest margin	**3.6%**	3.7%	3.8%
On a geographical basis, interest spread and margins were:			
Australia			
Interest spread on productive assets[2]	**3.2%**	3.3%	3.6%
Impact of impaired loans	**–**	(0.1)%	(0.2)%
Interest spread[1]	**3.2%**	3.2%	3.4%
Benefit of net non-interest bearing liabilities and equity[3]	**0.7%**	0.9%	1.0%
Interest margin	**3.9%**	4.1%	4.4%
New Zealand			
Interest spread on productive assets[2]	**2.8%**	2.9%	3.2%
Impact of impaired loans	**–**	(0.1)%	–
Interest spread[1]	**2.8%**	2.8%	3.2%
Benefit of net non-interest bearing liabilities and equity[3]	**0.2%**	0.5%	0.7%
Interest margin	**3.0%**	3.3%	3.9%

1 Interest spread is the difference between the average yield on all interest earning assets and the average rate paid on all interest bearing liabilities.
2 Interest spread on productive assets is determined on the basis of the interest spread formula after excluding non-accrual loans, and the interest relating thereto, from the equation.
3 The benefit of net non-interest bearing liabilities and equity is determined by applying the average rate of interest paid on all interest bearing liabilities to the average level of these funds. The calculations for Australia and New Zealand take into account the interest expense/income of cross border, intragroup borrowing/lending.
4 Income received in the form of tax-rebatable dividends on redeemable preference shares, together with other tax-free interest income, has been grossed up to a pre-tax equivalent.

Group During 1997, interest spread for the Group increased by 0.1% to 2.9%, with a 0.1% reduction in the impact of impaired loans and the interest spread on productive assets remaining relatively steady at 2.9%.

Maintaining the spread on productive assets was assisted by the securitisation strategy, through removal of lower margin assets, and the hedging of balance sheet interest rate risk. The benefits of growth through acquisition, together with active capital management, also reduced the pressure to seek organic asset growth in the current environment. Asset growth has been pursued only where risk adjusted returns meet target requirements. This balanced approach to asset growth also contributed to the improved asset quality, with the benefits of lower impaired assets flowing into the net spread.

Interest margin for the Group declined by 0.1% to 3.6% in 1997, with the benefit of net non-interest bearing liabilities and equity declining from 0.9% in 1996 to 0.7% in 1997. This resulted from the change in the mix of funding for interest earning assets, with an increased proportion funded by interest bearing liabilities, reflecting the impact of the buy-back of share capital over the past 16 months.

AVERAGE BALANCE SHEET AND INTEREST RATES

	1997			1996			1995		
	Average Balance $m	**Interest $m**	**Average Rate %**	Average Balance $m	Interest $m	Average Rate %	Average Balance $m	Interest $m	Average Rate %
Assets									
Interest earning assets									
Due from other banks									
Australia	**845**	**51**	**6.0**	882	55	6.2	618	42	6.8
New Zealand	**1,009**	**93**	**9.2**	1,151	107	9.3	205	20	9.8
Other Overseas	**3,773**	**312**	**8.3**	4,159	394	9.5	4,138	266	6.4
Investment and trading securities									
Australia	**6,018**	**566**	**9.4**	4,698	378	8.0	5,167	352	6.8
New Zealand	**820**	**49**	**6.0**	664	56	8.4	1,079	90	8.3
Other Overseas	**1,967**	**125**	**6.4**	2,281	128	5.6	2,325	136	5.8
Statutory deposits									
Australia	**648**	**7**	**1.1**	617	15	2.4	533	32	6.0
New Zealand	**1**	**–**	**–**	1	–	–	1	–	–
Other Overseas	**292**	**17**	**5.8**	144	8	5.6	95	6	6.3
Loans and other receivables									
Australia	**57,087**	**5,073**	**8.9**	56,200	5,679	10.1	47,930	4,859	10.1
New Zealand	**19,695**	**2,040**	**10.4**	12,798	1,375	10.7	9,348	973	10.4
Other Overseas	**3,820**	**292**	**7.7**	4,153	316	7.6	4,643	338	7.3
Impaired loans									
Australia	**628**	**39**	**6.2**	1,230	61	5.0	1,917	79	4.1
New Zealand	**140**	**12**	**7.9**	190	9	4.7	200	15	7.5
Other Overseas	**84**	**2**	**2.4**	164	7	4.3	313	10	3.2
Intragroup receivable									
Other Overseas	**7,992**	**485**	**6.1**	6,319	412	6.5	6,318	332	5.4
Interest earning assets and interest income including intragroup	**104,819**	**9,163**	**8.7**	95,651	9,000	9.4	84,830	7,550	8.9
Intragroup elimination	**(7,992)**	**(485)**		(6,319)	(412)		(6,318)	(332)	
Total interest earning assets and interest income	**96,827**	**8,678**	**9.0**	89,332	8,588	9.6	78,512	7,218	9.2
Non-interest earning assets									
Cash, bullion, due from other banks and statutory deposits	**460**			582			561		
Other assets	**17,876**			16,055			8,380		
Provisions for doubtful debts									
Australia	**(1,511)**			(1,667)			(1,851)		
New Zealand	**(149)**			(128)			(136)		
Other Overseas	**(91)**			(107)			(161)		
Total non-interest earning assets	**16,585**			14,735			6,793		
Acceptances of customers									
Australia	**11,298**			12,058			11,899		
New Zealand	**13**			24			108		
Other Overseas	**55**			130			84		
Total acceptances	**11,366**			12,212			12,091		
Total assets	**124,778**			116,279			97,396		

AVERAGE BALANCE SHEET AND INTEREST RATES (CONTINUED)

	1997 Average Balance $m	**1997** Interest $m	**1997** Average Rate %	1996 Average Balance $m	1996 Interest $m	1996 Average Rate %	1995 Average Balance $m	1995 Interest $m	1995 Average Rate %
Liabilities									
Interest bearing liabilities									
Deposits									
Australia	**40,729**	**2,054**	**5.0**	39,662	2,448	6.2	33,838	2,040	6.0
New Zealand	**15,809**	**1,125**	**7.1**	10,043	779	7.8	6,415	478	7.5
Other Overseas	**8,843**	**492**	**5.6**	6,628	399	6.0	5,946	344	5.8
Public borrowings by subsidiary borrowing corporations									
Australia	**5,367**	**384**	**7.2**	5,399	419	7.8	5,023	397	7.9
New Zealand	**450**	**38**	**8.4**	501	41	8.2	425	31	7.3
Other Overseas	**16**	**2**	**12.5**	30	4	13.3	35	4	11.4
Due to other banks									
Australia	**300**	**19**	**6.3**	271	21	7.7	302	23	7.6
New Zealand	**81**	**11**	**13.6**	82	8	9.8	42	3	7.1
Other Overseas	**4,454**	**361**	**8.1**	6,520	559	8.6	7,212	471	6.5
Loan capital									
Australia	**2,001**	**157**	**7.8**	2,641	168	6.4	2,929	193	6.6
New Zealand	**52**	**5**	**9.6**	(61)	–	–	–	–	–
Other interest bearing liabilities									
Australia	**4,371**	**318**	**7.3**	3,645	289	7.9	1,409	67	4.8
New Zealand	**846**	**121**	**14.3**	225	35	15.6	89	10	11.2
Other Overseas	**2,096**	**111**	**5.3**	1,918	96	5.0	2,106	131	6.2
Intragroup payable									
Australia	**4,118**	**236**	**5.7**	3,319	217	6.5	3,393	177	5.2
New Zealand	**3,874**	**249**	**6.4**	3,000	195	6.5	2,745	155	5.6
	93,407	**5,683**		83,823	5,678	6.8	71,909	4,524	
Intragroup elimination	**(7,992)**	**(485)**		(6,319)	(412)		(6,138)	(332)	
Total interest bearing liabilities and interest expense	**85,415**	**5,198**	**6.1**	77,504	5,266	6.8	65,771	4,192	6.4
Non-interest bearing liabilities									
Deposits and due to other banks									
Australia	**3,169**			3,143			3,791		
New Zealand	**1,168**			686			749		
Other Overseas	**448**			436			445		
Other liabilities	**15,229**			14,203			6,942		
Total non-interest bearing liabilities	**20,014**			18,468			11,927		
Acceptances									
Australia	**11,298**			12,058			11,899		
New Zealand	**13**			24			108		
Other Overseas	**55**			130			84		
Total acceptances	**11,366**			12,212			12,091		
Total liabilities	**116,795**			108,184			89,789		
Ordinary shareholders' equity	**7,380**			7,489			7,002		
Preference shareholders' equity	**600**			600			600		
Outside equity interests	**3**			6			5		
Total shareholders' equity	**7,983**			8,095			7,607		
Total liabilities and shareholders' equity	**124,778**			116,279			97,396		

AVERAGE BALANCE SHEET AND INTEREST RATES (CONTINUED)

	1997			1996			1995		
	Average Balance $m	**Interest $m**	**Average Rate %**	Average Balance $m	Interest $m	Average Rate %	Average Balance $m	Interest $m	Average Rate %
Interest earning assets									
Australia	**65,226**	**5,736**	**8.8**	63,625	6,188	9.7	56,165	5,364	9.6
New Zealand	**21,665**	**2,194**	**10.2**	14,804	1,547	10.4	10,833	1,098	10.1
Other Overseas	**9,936**	**748**	**7.5**	10,903	853	7.8	11,514	756	6.6
Group	**96,827**	**8,678**	**9.0**	89,332	8,588	9.6	78,512	7,218	9.2
Interest bearing liabilities									
Australia	**56,886**	**3,168**	**5.6**	54,876	3,562	6.5	43,501	2,720	6.3
New Zealand	**21,112**	**1,549**	**7.3**	13,851	1,058	7.6	6,971	522	7.5
Other Overseas	**7,417**	**481**	**6.5**	8,777	646	7.4	15,299	949	6.2
Group	**85,415**	**5,198**	**6.1**	77,504	5,266	6.8	65,771	4,191	6.4
Interest spread									
Australia			**3.2**			3.2			3.4
New Zealand			**2.8**			2.8			3.2
Other Overseas			**1.0**			0.4			0.4
Group			**2.9**			2.8			2.8

Australia During 1997, Australian interest spreads remained relatively steady at 3.2%.

A number of key strategies have positively impacted spreads in Australia, allowing Westpac to continue to price products competitively in the markets. The benefits of Westpac's hedging of interest rate risk are demonstrated by the increase in the average rate earned on trading securities from 8.0% in 1996 to 9.4% in 1997. Additionally, Westpac's securitisation program has had a positive impact, by removing relatively lower interest yield loans from the balance sheet.

Spreads also benefited from a fall in the impact of impaired loans from 0.1% in 1996 to almost nil in 1997, reflecting a 37.5% reduction in the level of gross impaired assets over the period, combined with improved collections increasing the average rate earned on impaired loans from 5.0% in 1996 to 6.2% in 1997.

With the benefit of net non-interest bearing liabilities and equity declining from 0.9% in 1996 to 0.7% in 1997, interest margins in Australia declined over the year to 3.9%.

New Zealand The interest spread in New Zealand remained relatively steady in 1997, with the fall of 0.1% in the spread on productive assets offset by a 0.1% reduction in the impact of impaired loans.

With the purchase of Trust Bank New Zealand in May 1996, an increased proportion of New Zealand's interest earning assets are funded by interest bearing liabilities resulting in a fall in the interest margin of 0.3% to 3.0% in 1997.

Non-interest income analysis

The components of non-interest income are detailed in note 3 to the financial statements.

Non-interest income increased by $267 million or 18.1% to $1,739 million in 1997 and by $81 million, or 5.8%, to $1,472 million in 1996. The increase in 1997 was due to growth in loan fees, non-risk fees and the full year impact of Trust Bank New Zealand (estimated at $64 million). Non-interest income now accounts for 34.2% of total operating income, up from 31.1% in 1996. This improvement was broad-based across business lines and is reflective of Westpac's focus on enhancing non-interest revenues. Westpac's recent acquisitions, for example, all have relatively low non-interest income to total income ratios, ranging between 16% for Bank of Melbourne and 25% for Trust Bank New Zealand. The aim is to enhance this through providing their customers with a better and more comprehensive range of products, developing new non-interest earnings streams, such as mortgage servicing, and the gradual movement to recover more of the costs of providing transactional and other services.

Loan fees increased by 19.3% in 1997, reflecting continued movement towards partial cost recovery, such as the introduction of overdrawn account fees, as well as the improved collection of fees through automated collection procedures via the implementation of the Branch Service Platform. In addition, there has been a shift from risk fees to loan fees due to a change in the approach to pricing of bills of exchange.

In 1997, non-risk fees increased by $70 million or 10.3% due to new fee initiatives, strong growth in card merchants business as a result of the successful launch of the Global Rewards Visa Card, and the full year impact of Trust Bank New Zealand (estimated at $44 million). In addition, the retained spread over the investor margin on securitised assets has generated new non-risk fee income.
Increased customer and trading activity resulted in an 8.9% increase in financial markets non-interest income.

The 1997 increase in other income resulted from the sale of equity investments, profits on sale of assets acquired through security enforcement and the sale of other properties, resulting from the continued rationalisation of Westpac's CBD property portfolio and the ongoing branch sale and leaseback program.

Westpac's strategy is to continue to improve non-interest income through initiatives aimed at providing value added products and services for the extensive customer base, and in particular, focusing on the opportunity provided by recent acquisitions.

Provision for bad and doubtful debts

Westpac's policy is to create specific provisions promptly for any identified probable credit losses and to create general provisions for losses that can reasonably be expected to arise from the existing loan portfolios over their remaining lives based on relevant historical experience. Under dynamic provisioning, which is used to guide management in setting total provisions, the level of expected losses which may arise from the existing portfolio of credit exposures is calculated by applying a set of historically derived loss factors, adjusted to reflect changes in the underlying business. The resulting level of total provisions should be sufficient to cover loan losses inherent in the current loan portfolios. As the portfolio size, composition, inherent risk and loan loss experience change, the level of total provisions is adjusted.

The total charge against profits for provisions for bad and doubtful debts in 1997 was $78 million, a decrease of 36% from the 1996 charge of $121 million, which, in turn, was a decrease of 63% from the 1995 charge of $330 million.

The balance of the general provision decreased by $67 million in 1997 to $1,249 million, reflecting reduced exposures due to securitisation initiatives, and loan grade improvements as a result of the continued focus on improving credit management procedures.

Specific provisions have reduced to $339 million at 30 September 1997 from $531 million in 1996, as a result of the decrease in the level of impaired assets. New impaired assets fell to $405 million from $594 million in the prior year.

BAD AND DOUBTFUL DEBT CHARGE

	1997 $m	1996 $m	1995 $m
New specific provisions	**146**	200	416
Specific provisions no longer required	**(213)**	(463)	(325)
Specific provisions (net)	**(67)**	(263)	91
General provisions (net)[1]	**145**	384	239
	78	121	330

1 Addition after recognition of write-offs and recoveries.

Non-interest expenses

The detailed components of non-interest expenses are set out in note 4 to the financial statements. Non-interest expenses in 1997 were $3,228 million, an increase of $179 million over the 1996 level of $3,049 million.

Excluding the full year impact of the acquisition of Trust Bank New Zealand and Challenge Bank, and restructuring expenses incurred in 1996, total non-interest expenses remained flat in 1997 due to tight management control across all expense categories.

The efficiency ratio improved from 64.5% in 1996 to 63.4% in 1997 reflecting the initial benefits arising from investment initiatives to centralise back office functions, combine core support activities to achieve economies of scale, and to further rationalise the branch network.

Tight expense management, together with the commencement of benefits from merger synergies and infrastructure investments over recent years, have resulted in a 6.2% improvement in the staff productivity ratio in 1997. Excluding restructuring expenses of $63 million in 1996 and the full year impact of Trust Bank New Zealand and Challenge Bank, staff costs have decreased by $71 million. The effective salary rate has increased by 4% in 1997 principally reflecting additional salary costs negotiated as part of the existing Enterprise Development Agreement. This has been more than offset by savings arising from the ongoing branch rationalisation program, merger synergies and the continued focus on improving efficiency. Further benefits are expected to be achieved in future periods, particularly given the potential synergies from the integration of Bank of Melbourne.

The rise in equipment and occupancy expenses in 1997 reflects increases in operating lease rentals and investment in technology. The operating lease rentals increased as a result of the branch sale and lease-back program, introduced as a mechanism to use capital more efficiently. Technology depreciation expense increases reflect Westpac's continued investment in systems infrastructure throughout 1996 and 1997, in particular the Mortgage Processing Centre, the Branch Service Platform and the centralisation of offshore processing into Australia.

The level of non-lending losses in 1997 was in line with normal expectations and underlying prior year levels. The low level of 1996 losses was principally due to the write-back of provisions no longer required.

In January 1997, Westpac launched its advertising campaign promoting Westpac as an Official Partner of the Sydney 2000 Olympic Games, and during the year product specific advertising linked to the Sydney 2000 Olympic Games commenced.

Income tax expense

INCOME TAX EXPENSE

	1997 $m	1996 $m	1995 $m
Excluding abnormal items			
Income tax expense	**493**	421	371
Tax as a percentage of operating profit before tax and abnormal items (effective tax rate)	**27.6%**	27.1%	26.7%
Including abnormal items			
Income tax expense	**493**	421	227
Tax as a percentage of operating profit (including abnormal items) before tax (effective tax rate)	**27.6%**	27.1%	19.3%

Westpac's effective tax rate was 27.6% in 1997. This was below the Australian company tax rate of 36% due to a number of items, including the receipt of rebatable and exempt dividends, non-assessable unit trust income, tax losses not previously recognised that were booked and utilised, adjustments for overseas tax rates and certain non-taxable capital profits.

In 1995 there were various abnormal tax expense and/or credit items. Significant items in 1995 included a $40 million tax credit to adjust provisions for deferred income tax and future income tax benefit balances arising from an increase in the Australian company tax rate from 33% to 36%; and a $67 million write-back of a $106 million tax provision created in 1992, following the settlement of prior years' tax issues with the US Internal Revenue Service.

For further information on income tax expense, see notes 5 and 6 to the financial statements.

Balance sheet review

The detailed components of the balance sheet are set out in the notes to the financial statements.

Westpac has maintained its disciplined approach to asset pricing to ensure appropriate marginal returns on capital and rewards for risk. The benefit of this approach can be seen in the maintenance of interest spreads.

	(Decrease)/Increase	
	1997 $bn	1996 $bn
Assets		
Due from other banks	**(2.3)**	1.4
Trading securities	**0.6**	(0.6)
Loans	**(3.3)**	16.8
Acceptance of customers	**–**	(0.5)
All other assets (net)	**2.4**	(1.4)
Net increase/(decrease)	**(2.6)**	15.7
Liabilities and shareholders' equity		
Due to other banks	**(0.8)**	(1.8)
Deposits and public borrowings	**(2.2)**	16.7
Acceptances	**–**	(0.5)
All other liabilities (net)	**0.1**	1.0
Shareholders' equity	**0.3**	0.3
Net increase/(decrease)	**(2.6)**	15.7

Assets Total assets declined by $2.6 billion, or 2.1%, to $119.0 billion at 30 September 1997, largely reflecting the impacts of securitisation and asset sales, as well as the reduction in prime asset requirements by the RBA. During 1996, total assets grew by $15.7 billion, or 14.8%, to $121.5 billion, of which $13.9 billion was due to the acquisitions of Challenge Bank and Trust Bank New Zealand.

Net loans and acceptances declined by $3.3 billion during 1997 reflecting the successful securitisation of an additional $2.9 billion of housing loans and the sale of Challenge Bank's Victorian assets of $1.2 billion.

Excluding the impact of securitisation and asset sales, Australian housing loans grew by $500 million or 2%. This reflected the impact of the integration of Challenge Bank, the implementation of the Mortgage Processing Centre and customers choosing to maintain higher loan repayments in the declining interest rate environment.

Continued focus on marketing of credit card products, together with the successful launch of the Global Rewards Visa and GM cards, has resulted in a 24% growth in outstandings in Australia. The 20% decline in overdrafts in Australia reflects an increasing diversity in the range of financing products available to business customers, with increasing use of both mortgage secured and other products.

In New Zealand, strong growth of 6% has been achieved in housing loans. Overall lending growth in New Zealand reflects the focus on maintaining core business growth, whilst completing the WestpacTrust integration.

Gross impaired assets, including off-balance sheet impaired assets, were reduced by $484 million, or 36% in 1997, reflecting continued improvement in asset quality and credit management, and the benefits of Westpac's dynamic provisioning approach on the overall portfolio.

Deposits due from other banks decreased by $2.3 billion, principally due to Westpac's centralisation of offshore treasury and financial market operations.

In June 1997, the RBA announced a reduction in the prime asset ratio (PAR) from 6% to 3%, enabling holdings of government securities to be reduced. This regulatory driven reduction was offset by an increase in securities held at the year end in response to trading opportunities.

The depreciation of the A$ against the US$ and the decline in interest rates resulted in a significant increase in other financial market assets and liabilities principally from the revaluation impact of off-balance sheet instruments.

Liabilities The overall level of liabilities of the Group has declined by $2.9 billion to $110.8 billion at 30 September 1997, reflecting the reduced funding needs of the Group as a result of the securitisation of $2.9 billion of housing loans together with the reduction in the PAR requirements. These reduced funding needs have been reflected in the decrease in deposits raised by the Group from the wholesale markets, particularly certificates of deposit, term deposits and bonds, notes and commercial paper.

In Australia, 15.3% growth in call deposits more than offset the decline in non-interest bearing deposits, as customers moved into interest bearing call deposit products, coupled with the continued underlying growth in core transaction and savings accounts. The strength of the growth in core deposits has been masked to some extent by the impact of the sale of Challenge Bank Victoria, which resulted in a decline in core deposits of $0.5 billion.

Capital management

Capital management in Westpac involves balancing the maintenance of a prudent level of capital, consistent with the risk undertaken, with the objective of maximising return to shareholders.

At 30 September 1997, shareholders' equity stood at $8.2 billion, up $0.3 billion from year end 1996. The buy-back of 35 million shares reduced equity by $251 million, but this was offset by 1997 earnings of $1,291 million, less dividends of $731 million. The ratio of tangible ordinary shareholders' equity to tangible assets at 30 September 1997 was 5.6%, compared with 5.1% at 30 September 1996.

The level of capital has remained strong following the merger with Bank of Melbourne, as shareholders representing over 95% of Bank of Melbourne shares accepted Westpac ordinary shares as part of the consideration.

On 3 November 1997, reflecting Westpac's strong capital position and its commitment to return excess capital to its shareholders, the Board announced an on market buy-back of up to 85 million ordinary shares (approximately 5%) over a period of up to six months, the fourth such program that Westpac has undertaken. The previous three programs have resulted in the repurchase and cancellation of 148 million ordinary shares, with consequent improvements to both return on ordinary equity and earnings per share.

Supported by the underlying growth in the capital base, the Board declared an increase in the final dividend on ordinary shares to 20 cents per share, taking the full year dividend on ordinary shares to 39 cents per share (fully franked) up from 33 cents per share (fully franked) in 1996.

RISK-ADJUSTED ASSETS

	Risk Weight %	Balance 1997 $m	Balance 1996 $m	Risk-adjusted Balance 1997 $m	Risk-adjusted Balance 1996 $m
On-balance sheet assets					
Cash, claims on the RBA, Australian Commonwealth Government securities under one year, & other zero-weighted assets	0%	**15,296**	13,218	**–**	–
Other claims on Australian Commonwealth Government, claims on state governments, OECD governments & central banks, & money market dealers	10%	**3,590**	4,289	**359**	429
Claims on OECD banks & local governments	20%	**5,590**	7,968	**1,118**	1,594
Loans secured by residential mortgages	50%	**40,152**	42,168	**20,076**	21,084
All other assets	100%	**54,335**	53,870	**54,335**	53,870
		118,963	121,513	**75,888**	76,977

	Contract or Notional Amount 1997 $m	Contract or Notional Amount 1996 $m	Credit Equivalent Amount 1997 $m	Credit Equivalent Amount 1996 $m	Risk-adjusted Balance 1997 $m	Risk-adjusted Balance 1996 $m
Off-balance sheet exposures						
Total off-balance sheet exposures	**554,233**	522,997	**24,789**	19,782	**11,245**	9,526
Total risk-adjusted assets					**87,133**	86,503

ELIGIBLE CAPITAL AND RELEVANT RATIOS

As at 30 September	1997 $m	1996 $m
Tier 1 capital		
Total shareholders' equity	**8,206**	7,891
Asset revaluation reserves	**(202)**	(260)
Intangible assets	**(1,029)**	(1,156)
Future income tax benefit net of deferred tax liability	**(11)**	(99)
Total tier 1 capital	**6,964**	6,376
Tier 2 capital		
Asset revaluation reserves	**202**	260
Subordinated undated capital notes	**695**	933
General provisions for doubtful debts	**1,249**	1,316
Future income tax benefit related to general provision	**(450)**	(474)
Eligible subordinated bonds, notes and debentures	**1,021**	1,114
Total tier 2 capital	**2,717**	3,149
Tier 1 and tier 2 capital	**9,681**	9,525
Deductions:		
Other banks' capital instruments	**(9)**	(9)
Investment in controlled entities or associates[1]	**(346)**	–
Capital in funds management and securitisation activities[2]	**(209)**	(182)
Net qualifying capital	**9,117**	9,334
Risk adjusted assets	**87,133**	86,503
Tier 1 capital ratio	**8.0%**	7.4%
Tier 2 capital ratio	**3.1%**	3.6%
Deductions	**(0.6)%**	(0.2)%
Net capital ratio	**10.5%**	10.8%

1 This deduction represents the Group's investment in Westpac Life.

2 This deduction has been made pursuant to the RBA's Prudential Statement C2 'Funds Management and Securitisation', issued in October 1995, which requires that where a bank (or another member of a banking group) invests capital in, or provides guarantees or similar support to, a controlled entity which undertakes the role of manager, responsible entity, trustee or custodian, then the capital or the guarantee will for capital adequacy purposes be deducted from the bank's, and the banking group's capital base.

Westpac is subject to risk-based capital adequacy requirements as determined by the RBA, which are generally consistent with the approach agreed upon by the Basle Committee on Banking Regulation and Supervisory Practices (Bank for International Settlements). Australian banks are required to maintain a minimum ratio of capital to risk-weighted assets of 8.0%. At least half of this capital must be in the form of 'core' or 'tier 1' capital. Subject to certain limitations, core capital includes shareholders' equity, i.e. paid-up share capital, retained earnings and certain reserves. The balance of eligible capital is defined as 'supplementary' or 'tier 2' capital. Certain deductions, such as investments in other banks' capital instruments, are also made. Supplementary capital includes, subject to limitations, asset revaluation reserves, general provisions for doubtful debts, mandatory convertible notes, perpetual floating rate notes and like instruments, and term subordinated debt, provided such term debt is not in excess of 50% of tier 1 capital.

In determining risk-adjusted assets, assets (including off-balance-sheet assets) are weighted according to notional credit risk. Classes of asset are assigned a risk-weighting according to the amount of capital required to support them. Five categories of risk-weights (0%, 10%, 20%, 50%, 100%), are applied to the different types of assets. For example, cash, bullion, claims on the RBA and short-dated Commonwealth of Australia securities have a zero risk-weighting, meaning that no capital is required to support the holding of these assets. Loans to corporations and individuals carry a 100% risk-weighting, meaning that they must be supported by capital equal to 8.0% of the amounts outstanding. Other asset categories have intermediate weightings, e.g. loans secured by residential housing mortgages generally carry a 50% weighting and claims on Australian and other OECD banks carry a 20% weighting. For loans secured by residential housing mortgages approved after 5 September 1994, where the loan-to-valuation ratio is in excess of 80%, a 100% risk weight applies. Off-balance-sheet exposures are taken into account by applying different categories of 'credit conversion factors' to arrive at credit-equivalent amounts, which are then weighted in the same manner as balance-sheet assets according to counterparty, except that, in respect of derivatives, a maximum weighting of 50% for corporations and individuals applies.

Effective 1 January 1998, the RBA will also require Australian banks to hold additional capital against market risk (the current regulations cover credit risk only). The effect of these market risk capital requirements will be minimal and can be easily accommodated within existing capital.

Differences between the Australian and United States definitions of tier 1 and tier 2 capital which would have a significant effect on Westpac are:

(i) Asset revaluation reserves which qualify as tier 2 capital under the RBA's guidelines do not so qualify under United States guidelines.

(ii) Under the RBA's guidelines, the general provisions for doubtful debts, net of associated future income tax benefits, qualifies as tier 2 capital. Under United States guidelines, the associated future tax benefit is not deducted from the general provision but, subject to the exemption in (iii) below, is a direct deduction from tier 1 capital to the extent that the future tax benefit exceeds off-setting deferred tax liabilities.

(iii) The United States guidelines allow net future tax benefits reversing within 1 year to be included in tier 1 capital up to a bank's projected annual income or 10% of core capital, whichever is less.

Certain differences between Australian GAAP and US GAAP, which are detailed in note 40 of notes to the financial statements, also give rise to differences between tier 1 capital calculated in accordance with Australian guidelines and tier 1 capital calculated in accordance with United States guidelines.

After adjusting for the above items and differences between Australian GAAP and US GAAP, Westpac's tier 1 and total capital ratios, at 30 September 1997, in accordance with United States guidelines, were 8.2% and 11.6% respectively.

Business group results

To enable a more meaningful analysis of Westpac's results, the following business group results have been presented on a management reporting basis. Consequently, internal charges and transfer pricing adjustments have been reflected in the performance of each business group. The basis of reporting reflects the management of the business within the Westpac Group, rather than the legal structure of the Group. Therefore, these results cannot be compared directly to the performance of individual legal entities within Westpac.

The following business results highlight the key business units and do not sum to the total Group result. The remainder of the business group result includes the general provision charge and the result of the Asset Management Group, which is responsible for managing impaired assets and any consequent recoveries, as well as sale of equity investments.

Australian Retail Banking and Financial Services represents the combined results of Westpac's Regional Banks, Australian Guarantee Corporation (AGC), as well as Westpac Financial Services. The increasing disintermediation of financial services in

Australia and the consequent focus on providing retail customers with a more comprehensive package of financial products, has resulted in increased product substitution and sales across traditional boundaries. Consequently, Westpac has moved progressively toward managing the portfolio in this manner.

Australian Retail Banking and Financial Services has continued the focus on providing retail customers with a complete financial package to meet their needs. This has been implemented via an integrated sales approach leveraged off the customer base of both the existing Westpac network and the customers acquired through Challenge Bank and Westpac Life. This has delivered strong growth in the sales of financial services and consumer finance products.

The successful and immediate integration of Westpac Life and strong inflows of non-superannuation personal investments, have seen funds under management in Australia grow from $10.3 billion to $15.2 billion at 30 September 1997. Westpac's Personal Portfolio Service and Fixed Term Annuity Product are two key products contributing to this growth. These products reflect Westpac's commitment to providing value adding products to customers, and the capacity to increase customer funds through alternatives to traditional banking products. For example, customers are able to choose between term deposits and term annuities, depending on their individual investment needs.

Westpac Financial Services further enhanced its insurance product set during the year with the formation of Westpac Lenders Mortgage Insurance, an alternative supplier for mortgage insurance to customers. Strong sales of consumer credit insurance and other general and life insurance products reflected the continued growth opportunities in these markets and the benefit of targeted cross selling initiatives.

Fee income growth reflects the impact of the gradual movement to recover more of the costs of providing transactional and other services. In addition, significant improvements have been made in processes for collecting transaction and special services fees automatically through the implementation of the new Branch Service Platform.

BUSINESS RESULTS – AUSTRALIAN RETAIL BANKING AND FINANCIAL SERVICES

	1997 $m	1996 $m	Movt %
Net interest income	**2,368**	2,529	(6.4)
Non-interest income	**726**	570	27.3
Operating income	**3,094**	3,099	(0.2)
Provisions for bad and doubtful debts	**(162)**	(118)	37.0
Operating income net of provisions for bad and doubtful debts	**2,932**	2,981	(1.6)
Non-interest expenses	**(1,961)**	(1,962)	–
Operating profit before tax	**971**	1,019	(4.7)
Tax and outside equity interests	**(335)**	(371)	(9.7)
Profit on operations	**636**	648	(1.8)
	$bn	$bn	
Deposits and other public borrowings	**34.8**	34.5	0.9
Net loans and acceptances	**50.0**	54.1	(7.6)
Total assets	**55.4**	60.5	(8.4)
Funds under management	**15.2**	10.3	47.6
Personnel numbers – (FTE)	**19,330**	21,769	
Expense/income (before intangibles)	**62.9%**	62.8%	
Productivity ratio	**2.85**	2.73	
Non-interest income/operating income	**23.5%**	18.4%	

Strong marketing efforts achieved an increase in the number of credit cards on issue, and an increase in merchant business and associated fee income. This growth is expected to continue due to the significant success of the Global Rewards Visa Card, one of the most successful Westpac product launches of recent times. Further benefits in this area will arise through Westpac's role as Official Partner of the 2000 Olympic Games which is expected to provide competitive advantages for Westpac.

The strategy of growth through acquisition has continued with the approval by shareholders of the merger with the Bank of Melbourne. The experience gained from the Challenge Bank merger will provide an invaluable benefit in ensuring an efficient integration process. This strategy is considered appropriate in the current low interest environment, where there is a risk that high levels of organic volume growth would require aggressive pricing and may result in increased bad debts when the interest rate cycle reverses. In recognition of this, Westpac has continued to price products competitively while improving the quality of the loan portfolio and focusing on appropriate return for risk. In addition, the sale of Challenge Bank's Victorian lending assets ($1.2 billion) and deposits ($0.5 billion), has contributed to the decline in net interest income ($30 million).

The provisions for bad and doubtful debts, at 0.3% of net loans and acceptances, reflects the quality of the portfolio. The increase in the provision at 30 September 1997 resulted from lower levels of write backs of provisions no longer required than in the year ended 30 September 1996. In 1997, the level of new specific and general provisions declined by $20 million.

Consistent with the Group focus on managing capital as efficiently as possible to improve shareholder value, strategies within the Regional Bank have included the securitisation of assets, particularly low margin loans, and the branch sale and lease back program. Westpac securitised a total of $2.9 billion of lending assets in 1997, through a mixture of private placements and public issues of securities to investors. This had the impact of reducing net interest income and increasing non-interest income through servicing income and retention of the excess over the investor margin. The branch sale and lease back program, whilst increasing leasing costs, has released capital to be directed to more efficient uses.

The Australian Regional Bank has continued to invest in infrastructure and projects designed to improve customer service, increase revenue streams and improve productivity and efficiency in the future, such as the Branch Service Platform and the NSW Operations Centre.

The improvement in the productivity ratio principally reflects the significant reduction in staff members achieved through ongoing rationalisation of delivery channels, enhanced efficiencies and merger synergies.

Institutional Banking provides services to institutional customers both in Australia and overseas in the areas of financing, transactional business, financial markets and corporate finance.

In 1997 operating profit before tax, excluding bad and doubtful debts, increased by $9 million. Lower levels of bad debt recoveries and reduced write-backs of provisions for doubtful debts have resulted in the reduction in profit in 1997 compared to 1996.

Operating income increased by $28 million predominantly due to continued growth in financial markets and corporate finance, offsetting the impact of declining margins in traditional corporate lending activities.

Income in the financial markets business increased by $20 million, or 8%, through increased customer and trading activity. There was a change in composition of financial markets income with net interest income down by $32 million and total non-interest income up by $52 million. Fluctuations in the mix between net interest income and non-interest income arise from changes in the mix of securities in the portfolio and movements in yields and coupon rates for these securities.

Corporate finance has grown income by $20 million, or 23%, following the successful involvement in several major transactions and the continued development of new products, targeted at the creation of innovative solutions for customers.

BUSINESS RESULTS – INSTITUTIONAL BANKING

	1997 $m	1996 $m	Movt %
Net interest income	**445**	490	(9.2)
Non-interest income	**405**	332	21.8
Operating income	**850**	822	3.3
Provision for bad and doubtful debts	**18**	68	(72.8)
Operating income net of provisions for bad and doubtful debts	**868**	890	(2.5)
Non-interest expenses	**(495)**	(476)	4.0
Operating profit before tax	**373**	414	(9.9)
Tax and outside equity interests	**(134)**	(135)	(0.9)
Profit on operations	**239**	279	(14.3)

	$bn	$bn	
Deposits and other public borrowings	**13.7**	13.1	4.5
Net loans and acceptances	**20.1**	19.4	3.8
Total assets	**38.6**	35.4	9.2
Personnel numbers – (FTE)	**2,431**	2,566	
Expense/income (before intangibles)	**58.3%**	57.9%	
Productivity ratio	**3.48**	3.55	
Non-interest income/operating income	**47.6%**	40.4%	

Contracting margins due to competitive pressures and the impact of cuts in official interest rates on corporate deposit products, have reduced net interest income in the lending and transactional businesses. Despite the less attractive margins, targeted lending to corporate customers continues to be an important element of the overall customer relationship. Westpac continues to be selective in providing lending facilities to ensure that the total customer relationship profitability provides an adequate return to shareholders.

The restructure of the offshore operations was completed during the year with financial markets processing and trading operations now centralised in Sydney. This makes Westpac one of the few banks in the world, and the first in Australia, to operate with this cost competitive advantage.

The total expenses increase has been restricted to 4%, despite the impact of one-off costs associated with the operations centralisation strategy ($7 million) and investment in infrastructure and technology platforms ($14 million), including RTGS and transactional services' developments and the upgrade of front office platforms. The centralisation and investment will enhance efficiency and improve service delivery to customers.

The loan book remains strongly provisioned and its overall quality has continued to improve over the year. The credit for provisions for bad and doubtful debts in 1997, while not involving the same magnitude of write-backs as 1996, reflects this improvement in loan quality.

New Zealand Retail (WestpacTrust) and Pacific Regional Banking provide retail financial services in New Zealand and the Pacific. In November 1996, WestpacTrust was announced as the new identity of the merged bank in New Zealand. The merger and full integration is progressing ahead of schedule with merger efficiencies already arising as reflected in lower FTE and personnel costs, and the significant improvement in the expense to income ratio. Full branch network integration is expected to be finalised by the end of the 1998 financial year.

The improvement in operating profit for New Zealand resulted in part from the full year impact of Trust Bank New Zealand, growth in the underlying business and the savings achieved as a result of merger synergies (approximately $60 million) partially offset by the integration expenses (approximately $25 million). This has been achieved in a challenging operating environment (resulting from the merger process) and reflects management's focus on customer retention.

In addition to the full year impact on net interest income of Trust Bank New Zealand (estimated at $224 million), growth was also achieved through higher loan volumes, with core deposit levels maintained. The efficiencies achieved through the merger process assisted WestpacTrust in providing competitively priced products to the market, with some reduction in net interest income resulting.

BUSINESS RESULTS – NEW ZEALAND RETAIL AND PACIFIC REGIONAL BANKING

	1997 $m	1996 $m	Movt %
Net interest income	**784**	513	52.9
Non-interest income	**331**	262	26.4
Operating income	**1,115**	775	43.9
Provision for bad and doubtful debts	**(29)**	(6)	384.4
Operating income net of provisions for bad and doubtful debts	**1,086**	769	41.3
Non-interest expenses	**(664)**	(526)	26.3
Operating profit before tax	**422**	243	73.7
Tax and outside equity interests	**(140)**	(81)	72.8
Profit on operations	**282**	162	74.1
	$bn	$bn	
Deposits and other public borrowings	**14.1**	14.3	(1.4)
Net loans and acceptances	**18.0**	17.6	2.5
Total assets	**19.9**	19.6	1.4
Funds under management	**1.1**	1.0	10.0
Personnel numbers – (FTE)	**7,899**	8,214	
Expense/income (before intangibles)	**56.0%**	66.2%	
Productivity ratio	**3.41**	3.04	
Non-interest income/operating income	**29.7%**	33.8%	

After allowing for the impact of the merger with Trust Bank New Zealand (estimated at $64 million), non-interest income has increased by $5 million through enhanced sales to the larger customer base.

Pacific Regional Banking experienced a decline in net interest income due to the continued impact of increasing competition. This reduction was partially offset by expense savings arising from ongoing rationalisation and efficiency gains.

Derivative activities

Derivative contracts include forwards, futures, swaps and options, all of which are bilateral contracts or payment exchange agreements, whose value derives from the value of an underlying asset, reference rate or index.

Derivatives may be transacted either 'over-the-counter' or on an exchange. Over-the-counter derivatives are negotiated privately between the counterparties. This allows transactions to be tailored to suit each customer's requirements. The individual nature of these derivatives means that they are not traded like securities. Instead, they may be terminated or assigned to another counterparty only with the agreement of the original counterparty. Over-the-counter derivatives include forwards, swaps and options. Exchange traded derivatives are standardised contracts transacted on a regulated exchange. Each contract has a buyer and a seller with the exchange acting as counterparty. The exchange accepts and manages credit risk through a system of margin calls. Exchange traded derivatives include futures and options. Definitions of individual types of derivatives are included in note 1(t) to the financial statements.

Derivatives are flexible and cost-effective tools for assisting in the management of interest rate, exchange rate and commodity exposures, and for structuring finance and investment strategies. Derivatives can give the ability to transfer or manage risk, improve liquidity, access cost effective funding, increase investment options and enhance yield.

Westpac uses derivative contracts in two distinct capacities; as a dealer and as an end-user comprising part of its asset and liability management activities.

Dealing activities As a dealer, Westpac undertakes sales, market making and discretionary trading activities. The primary objective is to derive income from the sale of products to meet customer needs. Westpac acts as an intermediary for derivatives transactions based on interest rates, exchange rates, equity prices and commodity prices and is a market leader in Australian and New Zealand dollar products.

To support sales activity, Westpac's market making activities involve providing quotes to other dealers who reciprocate by providing Westpac with their quotes. This helps maintain liquidity in Westpac's principal markets and assists in the transfer of risk. Westpac also trades on its own account in order to exploit arbitrage opportunities and market anomalies, as well as to take outright views on market direction. These activities are known as proprietary trading and represent a limited part of Westpac's dealing activities. Westpac does not act as a broker or agent of exchange-traded futures but uses futures for hedging transactions and risk management purposes. For commodity derivatives, Westpac acts as an intermediary only.

Westpac monitors dealing activity in terms of the total notional amount outstanding, the regulatory credit equivalent, and the replacement cost (for details refer to note 25 of the notes to the financial statements).

Total notional amounts outstanding is a measure of volume which may be used for examining changes in derivative activity over time. The notional amount is the face value of the contract and is used to calculate cash flows. Unlike an on-balance sheet financial instrument, the notional amount of a derivative does not reflect the amount at risk which is generally only a small fraction of this value.

At 30 September 1997, the notional amount outstanding was $486.8 billion ($455.2 billion at 30 September 1996).

Regulatory credit equivalent is calculated for capital adequacy purposes using the RBA guidelines. Credit equivalent amounts are calculated as replacement cost (positive mark-to-market) plus an add-on for potential credit exposure based on a predetermined percentage of the notional amount. For example, for interest rate contracts with residual maturities of greater than one year the add-on is 0.5% of the notional amount. For exchange rate contracts the add-on percentages are 1.0% for residual maturities less than one year and 5.0% for one year or longer.

At 30 September 1997, regulatory credit equivalent was $13.9 billion ($10.0 billion at 30 September 1996).

Replacement cost/positive mark-to-market is the cost of replacing all transactions in a gain position to Westpac and is included in 'other assets' on the balance sheet. This measure is the industry standard for the calculation of current credit risk. Conversely, **negative mark-to-market** represents the cost to Westpac's counterparties of replacing all transactions in a loss position to Westpac and is included in 'other liabilities' on the balance sheet. The mark-to-market values do not include any offsetting physical positions that may exist, including structural balance sheet positions, and they do not include any benefits from netting.

At 30 September 1997, total replacement cost was $8.7 billion and negative mark-to-market was $8.9 billion ($6.3 billion and $7.3 billion, respectively, at 30 September 1996). Average values for the 1997 year, based on an average of spot end-of-month balances were $7.4 billion and $8.2 billion, respectively, ($6.8 billion and $7.6 billion for year to 30 September 1996).

The increase in notional amounts outstanding, positive and negative mark-to-market and regulatory credit equivalent has been driven by the significant movement in the AUD/USD during the latter half of the year.

Leveraged transactions include an explicit leverage factor in the payment formula. The leverage factor has the effect of multiplying the notional amount such that the impact of changes in the underlying price or prices may be greater than that indicated by the notional amount alone. It is not Westpac's business strategy to deal significantly in leveraged derivative transactions. As a result there were no leveraged transactions outstanding at 30 September 1997.

End-user activities

As an end-user, Westpac uses derivatives to manage its structural interest rate and foreign exchange risk. The transactions arising from these end-user activities do not, in the majority, give rise to credit risk as they are largely transacted within the Westpac Group. Through its end-user activities gains and losses arise. These are accounted for as hedges in a manner consistent with the accounting treatment for the underlying exposures. This generally entails accrual accounting to match that of the underlying hedged loans and deposits (also refer to note 1(t) to the financial statements).

END-USER ACTIVITY

	Notional Amount	
Derivatives Outstanding	**1997 $bn**	1996 $bn
Interest rate		
Futures	**14.4**	8.7
Forwards	**1.1**	3.3
Swaps	**30.7**	24.7
Purchased options	**0.1**	0.2
Sold options	**–**	–
Foreign exchange		
Forwards	**3.3**	2.4
Swaps	**13.3**	7.1
Purchased options	**–**	–
Sold options	**–**	–
Total derivatives	**62.9**	46.4

Where hedge transactions are terminated prior to the maturity of the underlying exposures, gains or losses on termination are deferred and recognised over the remaining term of the maturity. As at 30 September 1997, the net amount of deferred losses in relation to terminated hedge contracts was $7 million which will be amortised to profit and loss.

NET DEFERRED LOSSES FROM TERMINATED HEDGE CONTRACTS

Amounts to be Amortised to Profit and Loss for years ending 30 September	$m
1998	(1)
1999	1
2000	2
2001	–
2002 and after	(9)
Total net losses	(7)

Financial markets income

In the financial statements, net interest income earned on securities and cash balances held in the normal course of financial markets business is included in the total net interest income reported. Non-interest income, derived from trading and distribution of financial markets products, including derivatives, is reported under either foreign exchange income or other financial markets income.
Financial markets income may also be presented in terms of underlying activity. The purpose of such classification is to provide results which reflect the way the financial instruments and associated risks are managed.
Both approaches are reconciled below:

RECONCILIATION OF FINANCIAL MARKETS INCOME

Year ending 30 September	**1997 $m**	1996 $m
By accounting line		
Foreign exchange	**182**	175
Other financial markets income	**56**	43
Net interest income	**113**	129
Total financial markets income	**351**	347
By business activity		
Foreign exchange (spot and options)	**149**	142
Interest rate contracts[1]	**202**	205
Total financial markets income	**351**	347

1 Interest rate and currency swaps, options, forward foreign exchange, forward rate agreements, financial futures, debt securities, debt-related financial futures and commodities.

Risk management within Westpac

Westpac's exposure to risk arises directly from its role as a financial intermediary and financial markets participant. These activities involve the acceptance of credit, market and operational risk. Organisationally within the Westpac Group, management of these risks is part of the Chief Credit Officer's responsibilities.
The measurement and management of risk is central to Westpac's total management processes which are discussed in the following sections.

Credit risk management

Overview Credit risk is the potential risk of financial loss resulting from the failure of customers to honour fully the terms and conditions of a contract with Westpac. It arises primarily from Westpac's lending activities, as well as from transactions involving certain foreign exchange and derivative transactions.
For credit risk management to be successful, it must operate within an organisation that understands risk, and in which is embedded the acceptance of all the responsibilities that go with shaping and safeguarding a credit portfolio.

Credit risk management principles Westpac's credit risk management principles set out, in simple terms, the architecture and the core values by which Westpac controls credit risk. A successful credit culture has several key attributes. It requires the visible and wholehearted support of the Board of Directors and management. A sense of balance and perspective, and acceptance of personal accountability is essential. There must also be embedded in the day to day credit process an effective control environment. Within Westpac this is a robust system of checks and balances, which ensure objectivity in credit approval decisions, and the control and integrity of the risk management process.

Credit policies Policies covering the broad areas of country risk, industry concentrations and large exposures and delinquency management are used as the principal means of governing exposures. Loan loss provisioning is based on objective statistical assessments known as dynamic provisioning, as discussed on page 58.

Control environment Westpac's control environment ensures that common prudential standards and practices are applied across Westpac in order to maintain the quality of the lending portfolio. In order to codify and communicate this approach, Westpac has developed core control principles of credit which underpin the credit risk management process:

- *Segregation of functions* – No one person is in a position to control sufficient stages of processing a credit transaction such that error or defalcation could occur without a reasonable chance of detection. The credit process is designed such that the functions of origination of credit, approval, preparation of documentation, settlement of facilities and portfolio monitoring and control are each performed by separate persons or departments.
- *Approval of facilities* – Credit facilities are approved only after a line responsible officer and credit officer have ensured that the credit has been evaluated against the business unit's approved underwriting standards and analysed and structured as appropriate for the risk.
- *Documentation and settlement facilities* – Preparation of formal documentation will only occur after an independent officer in the legal or operations area has ensured the credit has been approved by an authorised officer and that the facility documentation matches the terms of the credit approval. Customer access to credit facilities is only permitted after a similarly independent officer confirms valid documentation has been obtained.
- *Monitoring and control* – Credit management information systems are monitored to ensure that credit data is accurately recorded and reported. Credit facilities are monitored and controlled to ensure that all payments are collected in accordance with original terms and conditions, and so that any breaches or variations obtain appropriate credit approval. Relationship managed facilities and product programs are subject to regular review to reassess their risk profile and compliance with expected performance.
- *Problem management* – Problem credit facilities are monitored to ensure that workout and collection/recovery strategies are established, approved and actioned. Exposures are subject to frequent review and followed up with appropriate corrective action.

Management assurance The management assurance programme assures management that its credit risk policies and procedures are being observed, and requires management to provide such assurance to the Board of Directors.

Westpac's assurance program covers the management of credit risk, market risk and operational risk. The key credit risk components of this management assurance program (provided by line managers and independent credit and operations officers) are:

- *A process quality assurance* completed by line managers to affirm their satisfaction that the credit process is being conducted in accordance with credit policy. Where the assessment is less than fully satisfactory, management prepares an action plan to resolve the issue. Such early warning signals helps business and credit managers rectify any problems promptly.
- *A portfolio quality assurance* completed independently by line management and credit officers to affirm their satisfaction that the credit portfolio is accurately graded and impaired assets have been properly provisioned or written off. Officers responsible for credit management information also assess the accuracy and completeness of portfolio management information systems.
- *A control quality assurance* completed by credit officers independent of line management to affirm their satisfaction that appropriate control activities are in place, and that they are adequate and effective in assuring management that their directives are being carried out. Similarly, these managers carry out any necessary action to resolve identified problems.

The system allows senior management, on the basis of consolidated certificates, to affirm their satisfaction with the quality of the processes under their responsibility, and with the effectiveness of the controls which support that assurance.

Credit risk review submits its reports directly to the Board Credit and Market Risk Committee, and provides an independent appraisal of the portfolio and the credit process. Group Audit, which reports directly to the Board Audit Committee, provides assurance as to the effectiveness of the overall control environment.

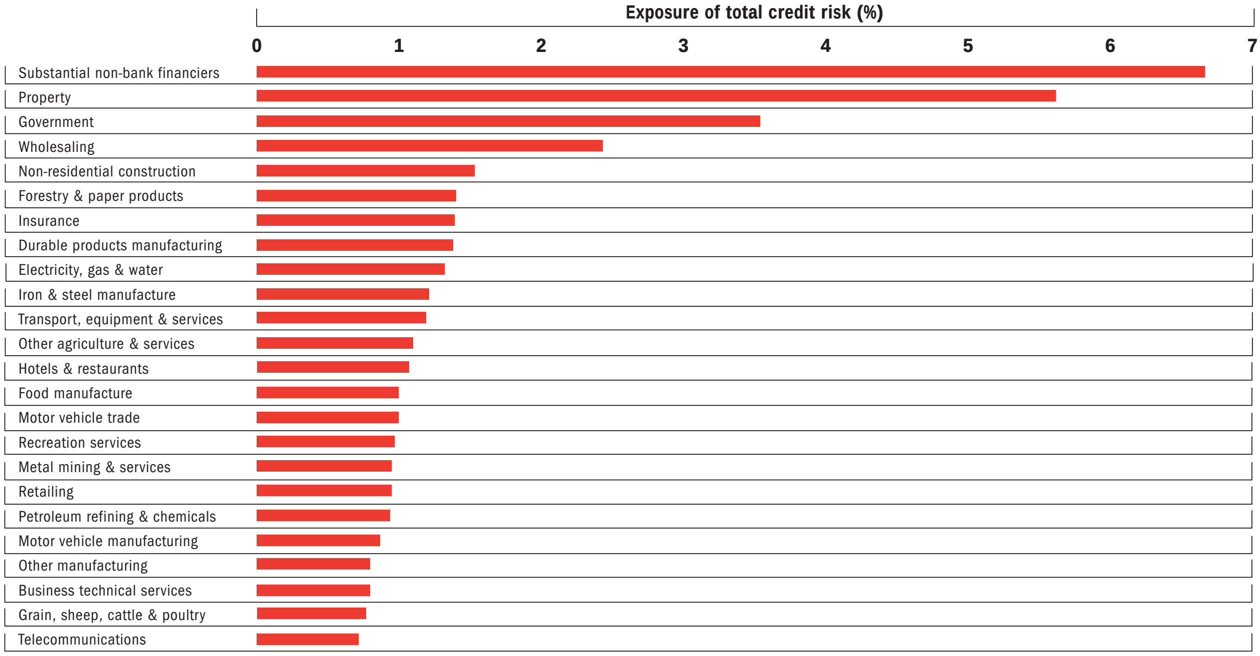
This system of management assurance permits the Board of Directors to be satisfied that Westpac's risk management systems are adequate, that they operate effectively, and that any deficiencies have been identified and are being addressed.

Portfolio management Westpac monitors its portfolio to guard against the development of risk concentrations. This process has ensured that Westpac's credit risk remains very well diversified throughout the Australasian economy.

Expressed in terms of commitments, about one third of the risk involves consumers. This category includes home loans, investment property loans to individuals, home equity loans, credit cards, finance company leases, personal loans, overdrafts and lines of credit. These customers are geographically highly diverse, with Westpac having a substantial market share in every state and territory in Australia, New Zealand and the Pacific, in city as well as country areas. Moreover, these customers service their debts with income derived from an extremely wide range of occupations. By far the greater part of the Group's consumer loans is secured by residential property.

The second major group of exposures is to the world's banking institutions representing about one sixth of the total commitments. Although these credit lines are mostly undrawn, they are monitored as if the funds are fully at risk since they can be used at short notice for financial market transactions and trading activities. These exposures, to 450 banks in 50 countries, are also well diversified. More than 90% of this exposure is to banks in 9 countries: Australia, Belgium, Canada, France, Germany, Japan, Switzerland, UK and USA. As with all business loans, Westpac limits its commitments according to bank credit ratings. It has only modest exposure to those banks that do not have strong credit ratings and has excluded others with lower ratings altogether.
All other exposures, to non-banking businesses and governments, constitute about half of the total committed credit risk. They are classified into 46 industry clusters. These clusters are based on the correlation between industries, grouping together those that tend to be affected by the same economic factors. Thus, industries that might suffer at the same time from increased risk are monitored collectively. The volatility of each cluster is used to set maximum exposure guidelines. More volatile clusters have lower exposure boundaries, having regard to the diversification they provide for the portfolio as a whole.
Westpac's principal exposures to businesses and corporate customers, excluding exposure to other banks, are shown in the following diagram. Some lending opportunities were not pursued during the year to avoid risk concentration.

CREDIT EXPOSURES TO GOVERNMENTS, CORPORATIONS AND BUSINESSES EXCLUDING BANKS



The cluster names are short titles for groups of similar industries.

Along with country and industry risk concentration limits and monitoring, Westpac establishes separate reporting and prudential limits for borrowings which can be accessed by a single customer group. These limits apply to both borrowing equivalents and settlement risk. Separate limits apply to corporates, governments, financial institutions and banks and are scaled by risk grade. Any excesses of limits are reported quarterly to the Board Credit and Market Risk Committee along with a strategy addressing the ongoing management of the excess.

Dynamic provisioning for loan losses Westpac determines the reserves it holds to cover future bad and doubtful debts by utilising, as a guide, a statistical process called dynamic provisioning to ensure that appropriate provisions are maintained at all times. During the year, Westpac released a publication explaining this methodology in response to the widespread interest in Westpac's bad debt provisioning.

Dynamic provisioning estimates the expected level of future credit losses from the loan portfolios. Statistical measures based on experience, supplemented by consideration of current market conditions, are used in estimating expected default rates and loss levels. Mass-market consumer loans, such as home loans and personal loans, are analysed by product portfolio. Loans to businesses are graded into different levels of risk, and the loss experience by each risk grade is determined. Furthermore the duration of the exposure is also taken into account: the longer the term of a loan, the greater the risk and therefore the larger the amount of provisioning required.

Dynamic provisioning is fully reflected in Westpac's internal management accounts. Consequently, a business unit which makes lower quality loans incurs higher provisioning charges. Conversely, a shift to higher quality business requires less provisions with the reduction credited to the business unit's profit and loss account. This encourages business units to accurately evaluate the risk in relation to the return generated by each new loan to ensure that the loan is correctly priced for risk.

Westpac constantly updates the factors used in dynamic provisioning in the light of its evolving loss experience.

The contribution to total provisions arising from the major classes of loan are shown in the following table.

	Proportion of Total Provisions %	Provisions as a Proportion of Loans in Each Class %
Loans to businesses		
Investment grade loans	6	0.1
Non-investment grade loans	39	2.2
Special mention, problem and impaired loans	34	25.5
	79	
Loans to consumers	21	0.5
Total provisions (general and specific provisions)	100	

Although investment grade and consumer loans constitute the greater part of Westpac's loan portfolio, they contribute only modestly to the need for provisions. The biggest contributor is the category of loans already showing stress or in default.

Foreign exchange and derivatives credit risk management The credit policies for foreign exchange and derivative activities are the same as those governing traditional lending products. Credit limits are set for each customer for all trading activities and are based on Westpac's assessment of the customer's credit standing. A real time global limits system records exposure against limits.

Foreign exchange and derivatives contracts involve two distinct elements of credit risk: pre-settlement and settlement risk. Pre-settlement risk occurs when the counterparty to a transaction is unable to comply with the terms of the contract and Westpac has to replace that contract at the current market value. Settlement risk occurs when Westpac pays out funds before it receives payment from the counterparty in the transaction.

By way of explanation, banks today exchange high-values during the day which do not get reconciled and settled until the next business day. If a bank cannot meet its obligations, that bank's failure could lead to liquidity difficulties for other banks. Within Australia, inter-bank settlement risk will diminish as the RBA progressively implements real time gross settlement (RTGS). This will reduce the risk of financial sector instability.

In assessing counterparty credit exposure on foreign exchange and derivatives transactions for internal credit management purposes, Westpac considers both the current replacement cost and the potential future credit risk. Potential future credit risk is the estimated 'worst case' potential increase in the replacement cost during the contract's life. This is calculated by employing a statistical methodology which uses historical price series, and assumes a one standard deviation move for the relevant period of future price exposure. This provides an 84% confidence level that the 'worst case' estimates will not be exceeded at any time over the contract's life. The sum of the current replacement cost and the potential future credit risk is used to measure exposure against limits.

The risk of customer default is reduced by dealing with creditworthy counterparties. Westpac's internal credit rating definitions are similar to those of the external credit rating agencies such as Standard & Poor's and Moody's. Ratings of AAA, AA, A and BBB represent investment grade ratings and ratings of BB and below represent non-investment grade. As at 30 September 1997, 98% of foreign exchange and derivative credit exposure was to investment grade customers (99% at 30 September 1996).

COUNTERPARTY CREDIT QUALITY

Total Assessed Credit Risk Exposure as at 30 September	**1997** **%**	1996 %
AAA, AA	**50**	43
A	**41**	49
BBB	**7**	7
BB and below	**2**	1
Total	**100**	100

The majority of foreign exchange and derivatives-related transactions are also short term:
63% mature within 1 year and 75% within 2 years (54% and 67% respectively at 30 September 1996).
The shorter the maturity profile, the less likely is the risk of an unexpected downgrading of the counterparty's credit worthiness.

CREDIT RISK MATURITY PROFILE

Replacement Cost as at 30 September 1997	0–3 months $bn	3–6 months $bn	6–12 months $bn	1–2 years $bn	2–5 years $bn	5+ years $bn	**Total** **$bn**
Interest rate							
Futures	–	–	–	–	–	–	**–**
Forwards	–	–	–	–	–	–	**–**
Swaps	0.1	0.2	0.3	0.6	1.2	0.7	**3.1**
Purchased options	–	–	–	–	–	–	**–**
Sold options	–	–	–	–	–	–	**–**
Foreign exchange							
Forwards	2.6	0.9	0.8	0.1	–	–	**4.4**
Swaps	0.2	–	0.2	0.3	0.1	0.1	**0.9**
Purchased options	0.1	–	0.1	–	–	–	**0.2**
Sold options	–	–	–	–	–	–	**–**
Commodity	–	–	–	–	0.1	–	**0.1**
Total derivatives	3.0	1.1	1.4	1.0	1.4	0.8	**8.7**

To reduce credit risk further, Westpac enters into master netting agreements that provide for the offset of contracts with positive and negative market values in the event of default. Netting agreements provide protection from a counterparty selectively honouring only those contracts in its favour.
In the United States, the existence of master netting agreements also provides a basis for the offsetting of contracts with positive and negative market values with the same counterparty for balance sheet purposes. International Accounting Standard IAS 32 and Australian Accounting Standard 1033, however, do not permit such offsetting unless there is an intention to settle on a net basis or settle simultaneously on a gross basis. Westpac currently follows the requirements of IAS 32 and AASB 1033, in reporting these items on a gross basis without regard to the existence of master netting agreements.

Market risk management

Overview Market risk is the risk of earnings loss arising from adverse movements in levels and volatilities of interest rates, foreign exchange rates, commodity and equity prices. Westpac is exposed to market risk as a consequence of its customer focused and proprietary trading activities in financial markets and asset and liability management for the overall balance sheet.
Management of market risk arising from trading and other banking activities is segregated.

Trading activities include Westpac's trading, distribution, underwriting and investment activities. Westpac's primary market risk types arising from its trading activities are interest rate risk and foreign exchange risk and to a lesser extent other market risks which include commodity and equity risks, prepayment risk and credit spread risk.
The Board Credit and Market Risk Committee oversees policies, methodologies and limits arising from Westpac's trading activities. At the executive level, the Trading Risk Committee chaired by the Chief Credit Officer ensures that Westpac's trading activities and new products and services are commensurate with Westpac's risk appetite. Board approved trading limits are delegated to the Trading Risk Committee for functional management. These limits are further sub-delegated to global business managers and

dealing management based on business strategies, business managers' experience, concentration risk and volatility risk. Sub-limits are categorised by risk types (interest rate, foreign exchange, other), regions and product groupings. A separate and independent unit, Trading Risk Management, which is part of Group Risk Management, provides independent monitoring and reporting of market risk exposures against approved limits.

Westpac uses earnings-at-risk (EAR) as the primary method for measuring market risk exposure on Westpac's entire trading portfolio, including physical and derivative instruments, against Board approved limits. EAR takes into account all material market variables that may cause a change in the value of the trading portfolio, including interest rates, foreign exchanges rates, and their volatilities as well as correlation among these variables.

EAR is an estimate of the potential loss in earnings from an adverse market movement with a 99% one-tailed confidence level (2.33 standard deviations) and a one day time horizon. This implies that an actual daily loss might deviate from expected results approximately 1.0% of the time. In 1996, the model was based on a 97.5% one-tailed confidence level (1.96 standard deviations). The change in methodology from 97.5% to 99% ensures that Westpac aligns with the methodology required by the RBA from 1 January 1998.

The current EAR calculation methodology combines a linear variance/covariance matrix model for the non-option trading portfolio with a limited worst case simulation approach (contingent loss matrices) for the options trading portfolio. Both rely on the basic assumptions that all the market rates and prices covered are lognormally distributed and that Westpac's portfolio outcomes are normally distributed.

The following table presents the highest, lowest and average levels of risk achieved in each major market risk exposure category over the past two years.

DAILY EARNINGS-AT-RISK

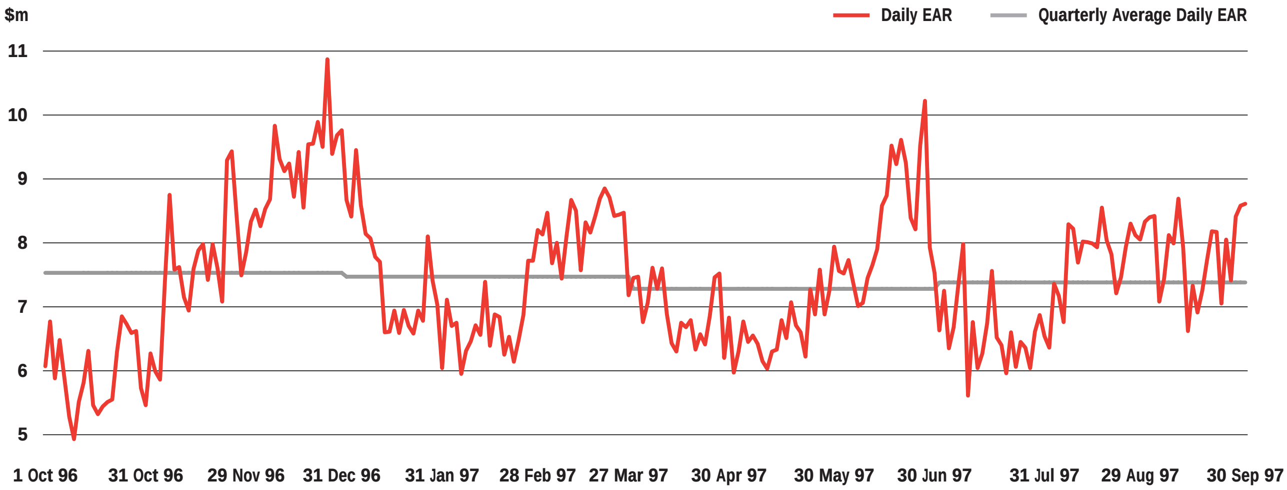
	High		Low		Average	
30 September	**1997 $m**	1996[1] $m	**1997 $m**	1996[1] $m	**1997 $m**	1996[1] $m
Interest rate risk	**7**	5	**2**	1	**4**	3
Foreign exchange risk	**5**	3	**1**	1	**3**	2
Other market risk	**2**	2	**1**	1	**1**	1
Aggregate market risk	**11**	7	**5**	3	**7**	5

1 The 1996 figures have been restated using a 99% confidence level from 97.5%. In 1996, the EAR for individual risk types were only available for the last quarter.

The aggregate EAR in 1997 averaged $7 million which represented the combination of interest rate risk of $4 million, foreign exchange risk of $3 million and other risk (predominantly credit spread market risk from debt securities activities) of $1 million offset by diversification of risks of $1 million. Aggregate risk is less than the sum of other risks due to correlation effects between risk types and instruments within the portfolio. The increase in market risk levels in 1997 is consistent with Westpac's overall strategy of increasing risk income from financial markets business within prudent exposure limits.

The graph below shows the aggregate daily earnings at risk for each trading day for the twelve months to 30 September 1997.

DAILY EARNINGS-AT-RISK

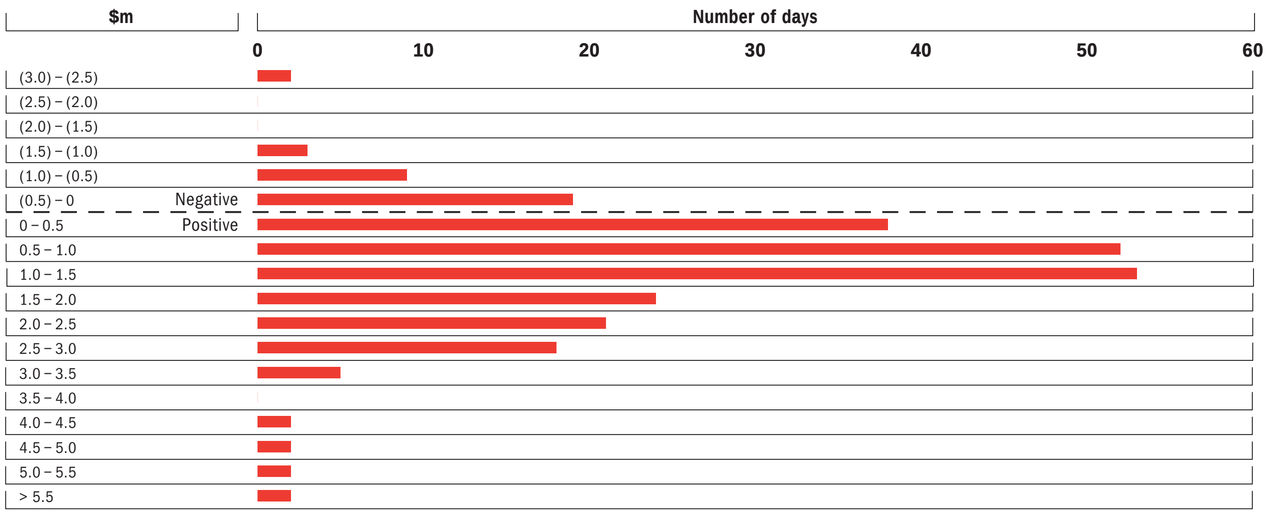


Westpac also establishes structural limits (value sensitivity and volume limits) and advice of loss procedures to manage the market risk of its trading portfolio. Advice of loss procedures ensure that any losses of a certain magnitude are promptly communicated to senior management.

EAR is supplemented by stress testing. Stress testing quantifies the effects of extreme movements in market factors (interest rate, currencies, volatilities, reduced liquidity), breakdown of correlations and scenarios such as the impact of a change in monetary policy on Westpac's trading portfolio.

The distribution of daily income is relatively stable which is consistent with Westpac's business strategy.

DISTRIBUTION OF DAILY INCOME



Other banking activities The Group Asset and Liability Committee (Group ALCO), chaired by the Chief Financial Officer, establishes policies regarding structural balance sheet interest rate market risk, foreign exchange rate risk and liquidity risk. These risks arise principally from mismatches which occur between the cash flows or repricing profiles of the various portfolios of loans, investments, deposits and other obligations. Group ALCO also has responsibility for analysing and deploying capital within the Westpac Group.

Management of structural interest rate risk Westpac's asset and liability management (ALM) function controls and manages the sensitivity of Westpac's net interest income (NII) to changes in wholesale market interest rates. The objective is to ensure the stability of NII regardless of changes to rates. Westpac uses a simulation model to manage this interest rate risk.

The position is managed within Board delegated NII at risk (NAR) limits. These limits are expressed in terms of the NII at risk over the next 12 months using a 97.5% confidence interval (given observed market rate volatilities) for movements in wholesale market interest rates (limit case shocks[1]). From 1 October 1997, a new limit structure will be in place which uses a 99% confidence interval and a three year time horizon. The position managed covers all of Westpac's on and off balance sheet, accrual accounted assets and liabilities. It excludes the interest rate risk on assets and liabilities managed within the Group's EAR framework (trading activities).

The NII simulation framework combines:

1) underlying balance sheet data with assumptions about new business (derived from the Group's internal forecast process),
2) the expected repricing behaviour of the Group's various lending and deposit benchmark rates, and
3) wholesale market interest rates.

Simulations of various interest rate scenarios are used to provide a range of NII outcomes. These scenarios include both up and down parallel rate shifts and the limit case shocks. The repricing behaviour of the lending and deposit benchmark rates is analysed in terms of behavioural models.

Both on and off balance sheet initiatives are then used to achieve stability in NII.

At 30 September 97, the Group's exposure to interest rate changes over the next 12 months for both 1% up and down parallel rate shocks and the up and down limit case shocks is less than 1% of the projected 12 month pre tax NII:

Movement in Interest Rates	Impact on Pre-tax Net Interest Income Forecast
+1%	between 0%–(1%)
−1%	between 0%–(1%)
Limit up[1]	between 0%–(1%)
Limit down[1]	between 0%–(1%)

1 Limit cases are defined in the current year as the 97.5% confidence level movement in wholesale rates given recent observed wholesale interest rate volatility.

Management of structural foreign exchange rate risk Westpac has capital deployed in offshore branches and controlled entities, which is denominated in currencies other than Australian dollars.

Current policy distinguishes between permanent capital and free capital. Permanent capital is defined as capital which is deployed in an offshore jurisdiction in order to meet regulatory requirements and is not anticipated to be repatriated in the foreseeable future. Free capital is defined as capital which comprises physical deployments and unrepatriated retained earnings which are expected to be repatriated at a projected finite future date. The level of permanent capital as a percentage of total capital deployed is not material.

Westpac's existing policy is to hedge all free capital. Unrepatriated current year earnings are hedged on an accrual basis as they are reported. This risk management policy ensures that Westpac's exposure to a decrease in the Australian dollar value of it's capital deployed offshore arising from movements in exchange rates is not material.

The identification and management of structural foreign exchange risk in relation to capital deployed is a continual process. The level of capital deployed and associated foreign exchange hedges is reported to Group ALCO on a monthly basis.

Liquidity risk management

Westpac's liquidity policies are designed to ensure that it has sufficient funds available, even in adverse circumstances, to meet its obligations, including advances to customers and maturities of deposits and other liabilities, while raising deposits from a wide range of sources at acceptable cost.

Liquidity is controlled by monitoring and managing current and future cash flows to contain the net cash outflow position during specified time intervals within acceptable parameters. The management process involves, in most circumstances, a series of limits on near term cash balances, beginning with next day, 8 day, 30 day, and 90 day limits on maximum cash outflows.

The liquidity policies applicable to different business units recognise different underlying structural liquidity. Separate limit structures and separate management processes are in place for Westpac's operations in each of Australia, New Zealand, convertible wholesale currency areas, and non-convertible currency areas.

Funding of Westpac's operations in various jurisdictions reflects differing depths and market structure. Group ALCO reviews the funding composition and mix of the major business units to ensure there is no undue concentration of reliance upon funding from particular investor groups, geographies, tenor, type of instrument or currency.

Operational risk management

Operational risk is the potential exposure to unexpected financial, reputational or other damage arising from the way in which the organisation pursues its business objectives. Key areas of operational risk include process error and fraud, system failure, customer service, security and physical asset protection, staff skills and performance, and product development and maintenance.

Senior management is accountable to the Board for maintaining an adequate and effective control environment that is commensurate with the organisation's risk appetite and business objectives.

Operational risk management is a continuous process which applies a combination of measures to avoid, reduce, transfer and otherwise manage operational risks within acceptable tolerance levels. Risk management techniques include appropriate systems, staff, internal controls and business continuity planning. These techniques are applied in a control conscious environment, with clarity of accountability and responsibility, and with certain formal policies such as the Westpac Employee Code of Conduct.

Westpac's business units build and maintain an understanding of their operational risk profiles and are expected to fully understand the likelihood and potential impact of any operational incidents. Analysis is structured around six broad areas of operational risk:

- *Organisational* – Assessment of the control consciousness of each business unit, the relevance and reliability of management information and whether delegations of responsibility, authority and limits are appropriate;
- *Product* – Assessment of the broad range of issues associated with the design and development of new products and services and the continuous review of the performance of existing offerings;
- *Customer* – Consideration of the factors which contribute to customer satisfaction: adherence to customer service standards, suitability of product to meet customer needs, responsiveness to customer concerns and integrity of customer information;
- *Staff* – Assessment of all the factors contributing to effective staff performance: skills and experience, staffing levels, training and development, remuneration and rewards, payroll, industrial relations, diversity, occupational health and safety, and communication;
- *Process* – Assessment of the day-to-day processing of customer transactions, including minimisation of error, delay and fraud, adequacy of security around banking systems, reliability and availability of information technology and other systems and processes, capacity planning, systems development, change implementation and regulatory compliance; and
- *Physical* – Assessment of the likelihood of loss, failure or theft of physical assets, including cash, negotiable securities, customer documentation, key equipment, telecommunications and premises together with the implications of any significant interruption to business;

While operational risk can never be eliminated, Westpac endeavours to minimise the impact of operational incidents by ensuring that the appropriate infrastructure, controls, systems, staff and processes are in place. Some of the key management and control techniques are set out below.

- A strong risk management culture is actively promoted which accords high value to disciplined and effective risk management. An operational risk policy has been established to guide the management of the Group's operational risks. Comprehensive risk identification and assessment techniques are employed to assist business management apply appropriate methods of risk monitoring and control. Key predictive indicators of operational risk which are tracked include business planning and variance analysis, market share analysis, customer satisfaction and retention data, staff turnover and satisfaction levels, occupational health and safety incidents, processing service standards and cycle times, outstanding, unprocessed or backlog items, fraud, theft and robbery statistics, and error and exception reporting.

- The principles of clear delegation of authority and segregation of incompatible duties are fully reflected in Westpac's operating processes. Movement of support functions into a limited number of centralised sites has provided the opportunity to implement improved operational discipline over activities previously performed across a widely distributed network.
- Comprehensive product development and product review programs have been established to ensure that Westpac's products meet customer expectations, regulatory requirements, performance criteria and operational effectiveness.
- Sound project management and change implementation disciplines are applied to all major development projects including new acquisitions, new technology applications, centralisation of retail and wholesale banking operations centres and other major initiatives.
- Westpac possesses extensive back-up and recovery capabilities and engages in business continuity planning and testing to ensure ongoing service delivery and restoration of normal business functions under adverse conditions.
- The commitment, competency and capability of Westpac staff are critical for the effective management of operational risk. Ongoing training and career development is emphasised to constantly improve the skills of its workforce. Selective recruitment, succession planning, and other human resource policies and practices are in place to ensure that staff skills are commensurate with the needs of the organisation.
- Westpac maintains various insurance policies to provide protection from losses arising from a diverse range of circumstances which include, but are not limited to, fraud, fidelity, forgery, theft, counterfeiting, legal liability for third party loss, and loss due to damage or destruction of physical assets.
- In addition to the implementation of operational risk management and reporting by all business groups, Group Audit completes independent appraisals of the effectiveness of the business risk management framework, reporting to management and to the Board Audit Committee.

During 1997 and going into 1998, Westpac has been involved in a number of major projects to improve operational processes, some of the most significant of which are:

Year 2000 project The origin of the Year 2000 'millennium bug' problem lies in the way information in computer systems relating to calender dates has been stored. Computer systems, built when data storage was expensive, saved only the last two digits of a year for date calculations in order to reduce data storage requirements. These systems are therefore unable to differentiate, for example, between the years 1900 and 2000. This inability to differentiate between the different centuries could result in discrepancies such as erroneous interest rate calculations and inaccurate statement reporting.

In recognition of the seriousness of the problem, work within Westpac began in 1996 when a Year 2000 project was initiated. The conversion plan for making Westpac's applications Year 2000 compliant is estimated to cost $57 million, of which $8 million has been spent to date. To the maximum extent possible, the project will utilise existing Westpac resources.

Westpac's objective is that all critical systems are Year 2000 compliant by September 1998, to allow adequate time for testing and to minimise resource requirements in later years. It is anticipated that the balance of the Year 2000 project conversion will be completed by December 1998.

Consumer loan delinquencies Significant process changes have been made to Westpac's consumer collection activities so that borrowers with overdue payments are firstly reminded in a timely fashion and later, if required, actively encouraged to retire overdue borrowings. Greater use of automated dialling facilities and more strategic timing of reminders and follow up of promises, have seen a significant reduction in overall delinquency levels across all consumer loan areas.

Transaction processing The increasing use of automated systems in centralised sites is central to reliable transaction processing, management information and application of internal controls, thereby reducing the risk of human error or criminal activity. Significant investment is being made in both front-office and back-office systems to improve the efficiency and security of processing environments. Systems and equipment are updated as required in response to changing business conditions and technology needs. Westpac has embarked on a project of centralising processing for financial markets transactions. This involved relocating operations and finance tasks previously performed in New York, Tokyo and London into a single twenty four hour operation based in Sydney. Although this was primarily undertaken for Westpac to transact on a single name basis and to deliver cost and productivity benefits, the initiative has delivered improved controls as processes are streamlined and re-engineered. The move to more central processing has led to improved data management and review.

Integrating acquisitions The future integration of the recently acquired Bank of Melbourne follows the successful acquisition and integration of Challenge Bank in Western Australia and ongoing integration of Trust Bank New Zealand. Project management activity is directed towards minimising customer and staff impact and the rationalisation of products, systems and processes.

Corporate governance

Good corporate governance establishes and maintains a legal and ethical environment which is responsible to all company stakeholders and, in particular, to shareholders. The fundamental test of good corporate governance is the generation of sustainable and enduring improvement in shareholder value.

Role of the Westpac Board of Directors The Board oversees the business and affairs of Westpac, approves the financial objectives and the strategies to be implemented by management and monitors standards of performance and issues of policy, both directly and through its committees.

In addition to participating in regular Board and committee meetings to consider and provide leadership on issues of strategic significance, the Directors regularly visit the operations of the Bank and, from time to time, meet informally with staff and customers.

The Board also has in place a program of mid-year shareholder meetings in major cities outside Sydney which provide an open forum for shareholders to meet with the Board (through the Chairman and the Managing Director).

The Westpac Deed of Settlement The first bank to be established in Australia, Westpac was founded in 1817 and was incorporated in 1850 as the Bank of New South Wales by an Act of the New South Wales Parliament. In 1817, the Deed of Settlement (the 'Deed'), which governs the relationship between Westpac and its shareholders, was also created. It remains in force today though it has, over the 180 years, been subject to a number of amendments. It equates to the articles of association of Westpac. The Deed sets out the rules by which shares are owned and transferred, meetings are held, voting occurs, and Directors, officers, auditors and other representatives are appointed.

As a public listed entity and an Australian bank, Westpac's affairs are also regulated by much of the Corporations Law.

Board composition and procedures The Board determines its own size as allowed by the Deed; the Deed provides that the minimum number of Directors be seven, the maximum fifteen, of whom only three may be executive Directors.

The Chairman of the Board is a non-executive Director, elected by the full Board. Nominations for Board appointment are considered by the Board as a whole. In selecting suitable Board candidates, the Board takes into account the experience and diversity of existing Board members and selects candidates accordingly. The performance of executive Directors is regularly reviewed by the Board Remuneration Committee and the full Board. The performance of non-executive Directors is reviewed by the Chairman on an ongoing basis. Details of each of the present Directors are set out on pages 68 and 69.

The proceedings of the Board are governed by the Deed. There is no fixed term of office for non-executive Directors though, every year at the time of the annual general meeting, one third of the Directors must offer themselves for re-election. The Deed sets a retirement age of 72 for Directors.

Board independence Independent professional advice is available to the Board collectively, or to individual Directors, at Westpac's expense, on approval by the Chairman or, in the absence of that approval, by the Board.

Board remuneration Non-executive Directors are remunerated by fees determined by the Board within the aggregate Directors' fees pool limit of $1 million approved by shareholders in January 1996. Details of fees and other entitlements paid to Directors are set out in full in note 34 to the financial statements.

Directors' fees are comparable with those paid to directors of other major financial institutions and corporations. Directors also have entitlements to retirement benefits in accordance with arrangements approved by shareholders in January 1993.

Ethics Directors see ethical business conduct as a requisite standard of conduct at all levels in Westpac. Westpac's Code of Conduct contains five key principles accepted by and applicable to everyone:

- We act with honesty and integrity
- We abide by laws and regulations
- We respect confidentiality and the proper handling of information
- We avoid conflicts of interest
- We strive to be a good corporate citizen and achieve community respect

As well as the Code of Conduct, Westpac has in place a number of specific policies designed to ensure the maintenance of business ethics, including those governing workplace and human resources practices, insider trading, risk management and legal compliance.

Committee structure Three committees support the work of the Board.

The Board Audit Committee considers all matters concerning accounting and financial reporting, and internal risk controls. It reviews the interim and annual financial statements, and the activities of Westpac's internal and external auditors, as well as monitoring the relationship between management and the external auditors.

In particular, the Committee assists the Board in reviewing the effectiveness of Westpac's control environment in the areas of operations, financial reporting and legal/regulatory compliance. It also makes recommendations to the Board on the appointment and removal of the external auditors, reviews the terms of their engagement, and the scope and quality of the audit. The Committee's powers and procedures are governed by the Deed and the Committee's specific Terms of Reference.

Membership: W.B. Capp (Chairman), P.L. Baillieu*, Sir Llewellyn Edwards, I.R.L Harper and P.D. Ritchie, all non-executive Directors, were members of the Board Audit Committee during 1997.

* P.L. Baillieu retired from the Board and Committee on 20 January 1997.

The Board Credit and Market Risk Committee oversees matters relating to Westpac's risk taking activities and reviews Westpac's business and financial risks, including reviewing exposures for both credit risk and market risk. In particular, it reviews Westpac's portfolio for risk exposures, its risk-management practices, its prudential policies and the adequacy of provisions, both specific and general. It delegates credit authority to the Managing Director and Chief Credit Officer and monitors the credit performance of management through management reports and the independent reports of Credit Risk Review. (Detailed discussion of credit and market risk is contained in the financial review.) The Committee's powers and procedures are governed by the Deed and the Committee's specific Terms of Reference.

Membership: J.A. Uhrig (Chairman), J.B. Fairfax*, W.P. Hogan and E. Mahlab, all non-executive Directors, were members of the Board Credit and Market Risk Committee during 1997.

* J.B. Fairfax was appointed to the Board and Committee on 5 December 1996.

The Board Remuneration Committee reviews remuneration policies and practices, approves the reward levels of the general management group, approves merit recognition arrangements and staff option grants and makes recommendations to the Board on the remuneration of the Directors, including the Managing Director. The Committee's powers and procedures are governed by the Deed and the Committee's specific Terms of Reference.

Executive remuneration emphasises variable, performance-based pay and provides a significantly greater proportion of total compensation which is equity-based as executive officer level increases. As a result, executive officers have a greater proportion of total compensation at risk, meaning that payment will vary depending upon overall Westpac performance and individual and business unit contributions.

Long term incentive is achieved through participation in the Senior Officers' Share Purchase Scheme (SOSPS). The options granted under the SOSPS are in respect of Westpac's $1.00 ordinary shares. The exercise price in respect of an option is fixed on the basis of the market price of the underlying ordinary share on the day preceding the date of offer. The options cannot be exercised for at least three years, and expire after five years.

During the 1997 year, 15,164,000 options were issued to 432 eligible officers.

Membership: J.A. Uhrig (Chairman), W.B. Capp, Sir Llewellyn Edwards, W.P. Hogan, E. Mahlab and P.D. Ritchie, all non-executive Directors, were members of the Board Remuneration Committee during 1997.

Regional advisory boards In Western Australia, where some of Westpac's operations are conducted through the Challenge brand name, and in New Zealand for WestpacTrust, local executive management have the benefit of advisory boards. These boards assist in forging and maintaining relationships with the local community, shareholders and customers, and provide an independent overview of operations.

In Western Australia, R.E. Argyle (Chairman), A.E. Blanckensee and H.W. Sorensen were members of the advisory board during 1997.

In New Zealand, B.N. Kensington (Chairman), J.C. King, J.W. Walden, S.H. Suckling, I.F. Farrant, T.B. Layton, G.S. Pentecost and P.D. Wilson were members of the advisory board during 1997.

ATTENDANCE AT BOARD AND COMMITTEE MEETINGS

	Regular Board Meetings		Special Board Meetings		Board Audit Committee		Board Credit and Market Risk Committee		Board Remuneration Committee		Special Committee Meetings[1]	
Name	A	B	A[4]	B	A	B	A	B	A	B	A	B
J.A. Uhrig	12	12	4	3	–	1	4	4	4	4	5	1
P.L. Baillieu[2]	5	5	–	–	4	4	–	–	–	–	2	1
W.B. Capp	12	11	4	1	7	7	–	2	4	4	5	3
Sir Llewellyn Edwards	12	10	4	3	3	3	–	–	4	3	5	2
J.B. Fairfax[3]	9	8	4	3	–	–	3	3	–	1	4	–
I.R.L. Harper	12	11	4	4	7	7	–	1	–	1	5	4
W.P. Hogan	12	12	4	3	–	3	4	4	1	1	5	2
R.L. Joss	12	12	4	4	–	5	–	4	–	4	5	1
E. Mahlab	12	11	4	3	–	1	4	4	3	3	5	1
J.P. Morschel	12	12	4	2	–	7	–	3	–	1	5	4
P.D. Ritchie	12	12	4	2	7	6	–	–	4	4	5	3

Column A – Indicates the number of meetings held during the period the Director was a member of the Board and/or Committee.
Column B – Indicates the number of those meetings attended by the Director.
1 The membership of special committees comprises any two Board members.
2 Mr Baillieu retired from the Board on 20 January 1997.
3 Mr Fairfax was appointed to the Board on 5 December 1996.
4 Three meetings were held by teleconference.

DIRECTORS' HOLDINGS OF WESTPAC SHARES AS AT 12 NOVEMBER 1997

Name	Number of Ordinary Fully Paid Shares, Options and Converting Preference Shares	Non-beneficial[1]
J.A. Uhrig	53,000	547,527
W.B. Capp	12,616	
Sir Llewellyn Edwards	8,312	
J.B. Fairfax	100,000	234,943
I.R.L. Harper	39,516	534,527
W.P. Hogan	14,066	
R.L. Joss	1,666,667 3,333,334[2]	
E. Mahlab	10,500	534,527
J.P. Morschel	4,000 600,000[3]	
P.D. Ritchie	20,714	15,000

1 Certain of the Directors are trustees for a staff related fund and as trustees of that fund, they are considered to have a 'relevant interest' in those shares and shares subject to warrants.
2 Options issued under the Chief Executive Share Option Agreement.
3 Options issued under the J.P. Morschel Share Option Deed.

Political donations Each year the Board gives careful consideration to making political donations. It is the view of the Board at this time that Westpac should support the democratic process and democratic institutions in Australia by providing financial contributions to political parties. Westpac's policy is that any political donations be made at both the federal and state level on an even-handed basis to parties with significant parliamentary representation. In the twelve months to 30 June 1997, donations totalling $304,100 were made to political parties in accordance with this policy.
All donations are declared in accordance with the electoral laws.

Board of Directors

John Uhrig AO, BSc, DUniv, FAIM. Age 69.
Appointed Chairman October 1992, Director since November 1989. John Uhrig has broad industry and manufacturing experience and has participated in and contributed to a variety of government and community bodies. Chairman of Rio Tinto Limited, Santos Limited, Australian Minerals and Energy Environment Foundation and Adelaide Symphony Orchestra Pty. Limited. Deputy Chairman of Rio Tinto plc.

Robert Joss Age 56.
Appointed Managing Director January 1993. Robert Joss spent 22 years at Wells Fargo & Company, gaining experience in all facets of banking and financial services. He was a Vice Chairman of Wells Fargo from 1986 to 1993. Prior to Wells Fargo, he spent three years with the United States Treasury Department. Chairman of the Australian Bankers Association, a Trustee of the National Parks and Wildlife Foundation of New South Wales and a Director of the Clean Up Australia Foundation.

Barry Capp BE(Civil), BCom, BA. Age 64.
Director since May 1993. Barry Capp was employed for many years in financial and commercial roles and has had experience in company reconstructions. Chairman of National Foods Limited and Australian Infrastructure Fund Limited. Director of Freight Rail Corporation, Unimelb Limited, Tassal Limited and Hellaby Holdings Limited.

The Hon. Sir Llewellyn Edwards AC, MB, BS, FRACMA, LLD(h.c.), FAIM. Age 62.
Director since 1988. Sir Llewellyn Edwards has had extensive experience in Queensland state politics (including five years as Treasurer), business and in community service (Chairman World Expo 88 Authority and Chancellor of University of Queensland). Chairman of Multi Function Polis Development Corporation. Director of James Hardie Industries Limited, Peregrine Capital Australia Limited and TCNZ Australia Pty. Limited.

John Fairfax AM. Age 55.
Director since 1996. John Fairfax has considerable understanding of the financial services needs of the commercial and rural sectors and of the impact of production and information technology on industry strategy. He has extensive experience in the media industry and takes an active interest in community organisations including the Royal Agricultural Society of NSW. Chairman of Rural Press Limited Group and Cambooya Investments Limited. Director of Crane Group Limited and Australian Rural Leadership Foundation Limited.

Ian Harper AM, BA, LLB. Age 65.
Director since 1987. Ian Harper, previously a partner of Allen Allen & Hemsley since 1960 and now a consultant to that firm, has practised extensively in corporations law. He has held a variety of financial service company board positions over many years. Chairman of Capcount Property Trust, President of NSW Council of Australian Institute of Company Directors, Director of Mayne Nickless Limited and other companies. Mr Harper chairs the Westpac Staff Superannuation Plan Pty. Limited Board representing the main Board of Directors.

Warren Hogan MA, PhD, DSc(h.c.). Age 68.
Director since 1986. Warren Hogan has been Professor of Economics at the University of Sydney since 1968. Adviser to business, government and international organisations including the World Bank, Harvard University Development Advisory Service and the Australian Stock Exchange. Director of the Principal Board, Australian Mutual Provident Society, 1993 to 1995.

Eve Mahlab AO, LLB. Age 60.
Director since October 1993. Eve Mahlab has practised as a solicitor, managed a family, owned and operated several successful small businesses and served on government and community boards. She has been extensively involved in community activities particularly those relating to business education, women and social change.

John Morschel DipQS, AAIQS, FAIM. Age 54.
Director since July 1993. John Morschel has broad experience in the property and construction industries and the life insurance and financial services industry. Director of CSR Limited and Mastercard International. Trustee of the Art Gallery of New South Wales. Mr Morschel was an executive Director over the reporting period with responsibility for the retail operations of the Westpac Group.

Peter Ritchie BCom, FCPA. Age 55.
Director since January 1993. Peter Ritchie has broad consumer marketing and commercial experience. Chairman and founding director of McDonald's Australia Limited and currently a member of McDonald's Malaysia and New Zealand Boards. Executive Chairman of Culligan NSW. Director of Seven Network Limited.

Helen Lynch AM. Age 54.
Appointed Director November 1997, following the adoption of the 1997 financial statements. Helen Lynch had 35 years' experience in Westpac including membership of Westpac's executive team before retiring in 1994. She is Chairman of the Superannuation Funds Management Corporation of South Australia, and a director of Coles Myer Limited, Southcorp Holdings Limited, Norwich Union Insurance Group and OPSM Protector Limited. She is also a director of the Centre for Independent Studies and The Garvan Medical Research Institute. In 1997 she was appointed a delegate to the Constitutional Convention.

Christopher Stewart Age 69.
Appointed Director November 1997, following the adoption of the 1997 financial statements. Christopher Stewart has been Chairman of the Bank of Melbourne since 1989. He was also Chief Executive Officer of that bank until his retirement in 1993 and was Managing Director of its predecessor, RESI-Statewide Building Society from 1979–1989. He is Chairman of Melbourne Water Corporation, and a director of Permanent Trustee Company Limited, Gandel Management Limited and Milton Corporation Limited. He is a Trustee of The Financial Markets Foundation for Children, and the Families in Distress Foundation.

Patrick Handley Age 52.
Appointed executive Director November 1997, following the adoption of the 1997 financial statements. Patrick Handley joined Westpac in 1993 with 18 years banking experience in the United States. At Banc One Corporation for 13 years, he was Chief Financial Officer for eight of them, with additional management responsibilities for its mortgage and leasing subsidiaries as well as its acquisition program. He is Group Executive and Chief Financial Officer of Westpac, with responsibility for finance, taxation and accounting, Group Treasury, Information Technology, Public & Consumer Affairs, Investor Relations and Australian Guarantee Corporation.

David Morgan BEc, MSc, PhD. Age 50.
Appointed executive Director November 1997, following the adoption of the 1997 financial statements. David Morgan has extensive experience in the financial sector, having worked at the International Monetary Fund in Washington in the 1970s, and the Federal Treasury in the 1980s where he headed all major areas before being appointed Senior Deputy Secretary. Since joining Westpac in 1990, he has managed all major operating divisions including Westpac Financial Services, Retail Banking, Commercial Banking, Institutional Banking, and International Banking. His current areas of responsibility are Institutional Banking, International Banking, and Westpac Financial Services.

Directors' report

The Directors of Westpac Banking Corporation report as follows on the affairs of Westpac Banking Corporation (the 'Parent Entity') and all the entities it controlled from time to time (collectively referred to as the 'Group') during the financial year ended 30 September 1997:

Directors The names of the Directors of the Parent Entity in office at the time of this report are J.A. Uhrig (Chairman), W.B. Capp, The Hon. Sir Llewellyn Edwards, J.B. Fairfax, I.R.L. Harper, Professor W.P. Hogan, R.L. Joss (Managing Director), E. Mahlab, J.P. Morschel and P.D. Ritchie. Particulars of their qualifications, experience and special responsibilities are set out under the headings 'Board of Directors' on pages 68 and 69 and 'Corporate Governance' on pages 65 to 67 and form part of this report.

Directors' meetings Particulars of the number of meetings of the Board of Directors and Committees of the Board held during the financial year which ended on 30 September 1997, together with details of attendance at those meetings by the Directors, are set out under the heading 'Attendance at Board and Committee Meetings' on page 67 and form part of this report.

Principal activities The principal activities of the Group in the course of the financial year which ended on 30 September 1997 were the provision of financial services including lending, deposit taking, payments services, investment portfolio management and advice, unit trust and superannuation fund management, nominee and custodian facilities, insurance services, consumer finance, leasing, factoring, general finance, foreign exchange dealing and money market services. No significant change in the nature of those activities occurred during the financial year.

Operating result The operating result of the Group for the financial year ended 30 September 1997 after tax and minority interests was a profit of $1,291 million.
The Directors' proposals as to appropriations are contained under the heading 'Dividends' and in note 7 to the financial statements.

Dividends A final dividend for the financial year ended 30 September 1996 of 17 cents per fully paid ordinary share, total amount $305 million, was paid by the Parent Entity on 28 January 1997, as a fully franked dividend. $307 million of this dividend was provided in the financial statements for the year ended 30 September 1996.
An interim dividend for the financial year ended 30 September 1997 of 19 cents per fully paid ordinary share, total amount $338 million, was declared by the Directors and paid on 4 July 1997 as a fully franked dividend.
A final dividend for the financial year ended 30 September 1997 of 20 cents per fully paid ordinary share, estimated amount $354 million, has been provided in the financial statements for the year ended 30 September 1997 and will be payable on 5 January 1998 as a fully franked dividend.
A dividend at the rate of 24.375 cents per converting preference share, total amount $19 million, was paid on 30 December 1996 as a fully franked dividend. $10 million of this dividend was provided in the financial statements for the year ended 30 September 1996.
A dividend at the rate of 24.375 cents per converting preference share, total amount $19 million, was paid on 30 June 1997 as a fully franked dividend.
A dividend at the rate of 24.375 cents per converting preference share, total amount $19 million, will be payable on 31 December 1997 as a fully franked dividend. $10 million of this dividend has been provided in the financial statements for the year ended 30 September 1997.
Details of dividends provided for or paid, including preference dividends, are set out in note 7 to the financial statements.

Review of operations A comprehensive review of the operations of the Group and the results of those operations for the financial year ended 30 September 1997 is set out on pages 10 to 64 and forms part of this report.

Significant events On 18 November 1996, the previously announced buy-back of 85 million, or approximately 5%, of the Parent Entity's fully paid ordinary shares by way of an on-market buy-back scheme, was commenced. 31.1 million shares were repurchased under the scheme.

On 1 January 1997, the Sydney Organising Committee for the Olympic Games (SOCOG) announced the appointment of the Westpac Group as the Official Bank of the Sydney 2000 Olympic Games and Official Bank of the Australian Olympic Team. The Partnership term extends until December 2000 and includes the Australian Olympic Team to the 1998 Winter Olympic Games.

On 3 April 1997, an agreement to merge with the Bank of Melbourne under Schemes of Arrangement was reached and the terms of the agreement publicly announced. Bank of Melbourne shareholder approval was obtained on 29 September 1997.

Under the merger offer, Westpac offered Bank of Melbourne shareholders either cash or a combination of cash and shares for Bank of Melbourne shares. The Westpac offer valued Bank of Melbourne at $1,435 million.

On 16 April 1997, Westpac signed a Co-operation Agreement with Standard Chartered Bank formalising a strategic relationship with that bank for the delivery of banking services in Asia.

On 2 May 1997, Westpac announced its intention to undertake a further buy-back of 50 million, or approximately 2.8%, of its fully paid ordinary shares by way of an on-market buy-back scheme. The buy-back became effective from 19 May 1997. As at 28 October 1997, 21.8 million shares had been repurchased under the scheme.

Events after end of financial year Other than as set out below, since 30 September 1997, no matter or circumstance has arisen that has significantly affected or may significantly affect:

- the operations of the Group;
- the results of those operations; or
- the state of affairs of the Group after 30 September 1997.

The Bank of Melbourne Schemes of Arrangement received final approval from the Victorian Supreme Court on 17 October 1997, by which time all regulatory approvals were to hand.

On 3 November 1997, Westpac announced its intention to undertake a further buy-back of 85 million, or approximately 5%, of its fully paid ordinary shares by way of an on-market buy-back scheme. The buy-back will be effective from 17 November 1997.

Mr John Morschel's resignation as an executive Director took effect as at 12 November 1997. Mr Morschel has accepted the Board's invitation to become a non-executive Director to take effect as at that date.

Ms Helen Ann Lynch and Mr Christopher John Stewart have accepted the Board's invitations to become Directors of the Parent Entity. Their appointment is to take effect as at 12 November 1997, following the adoption of the 1997 financial statements.

Dr David Raymond Morgan and Mr Roger Patrick Handley were appointed as executive Directors, to take effect as at 12 November 1997, following the adoption of the 1997 financial statements.

Future developments and results Likely developments in operations of the Group after 30 September 1997 and the expected results of those developments are contained in pages 11 to 14 and 17 to 36 and form part of this report.

Directors' shareholdings Particulars of shares in the Parent Entity or in a related body corporate in which Directors of the Parent Entity have relevant interests are set out on page 67 under the heading 'Directors' Holdings of Westpac Shares' and form part of this report.

Directors' interests in contracts As required by the Corporations Law, some Directors have given notice to the Parent Entity that, since the date of the last Directors' report, they hold office in specified companies and as such are to be regarded as having an interest in any contract or proposed contract which may be made between the Parent Entity and those companies.

Share options Information about share options granted during or since the end of the financial year is contained in note 21 to the financial statements and forms part of this report.

No person holding an option has or had, by virtue of the option, a right to participate in a share issue of any other body corporate.

Directors' benefits Since the end of the previous financial year, no Director of the Parent Entity has received or become entitled to receive a benefit other than:

- remuneration paid to non-executive Directors within the limit fixed by a resolution passed at the annual general meeting held on 24 January 1996 (see note 34 to the financial statements); or
- the fixed salary and other employee benefits, including share options, of a full time employee of the Parent Entity; or
- normal professional fees received by a firm of solicitors of which a Director is a consultant

by reason of a contract made by the Parent Entity, an entity that the Parent Entity controlled or a related body corporate, with the Director or with a firm of which he or she was a member or with an entity in which he or she has a substantial financial interest.

Rounding of amounts All amounts shown in this report have been rounded to the nearest million dollars.

For and on behalf of the Board of Directors

J.A. Uhrig
Chairman

R.L. Joss
Managing Director

12 November 1997