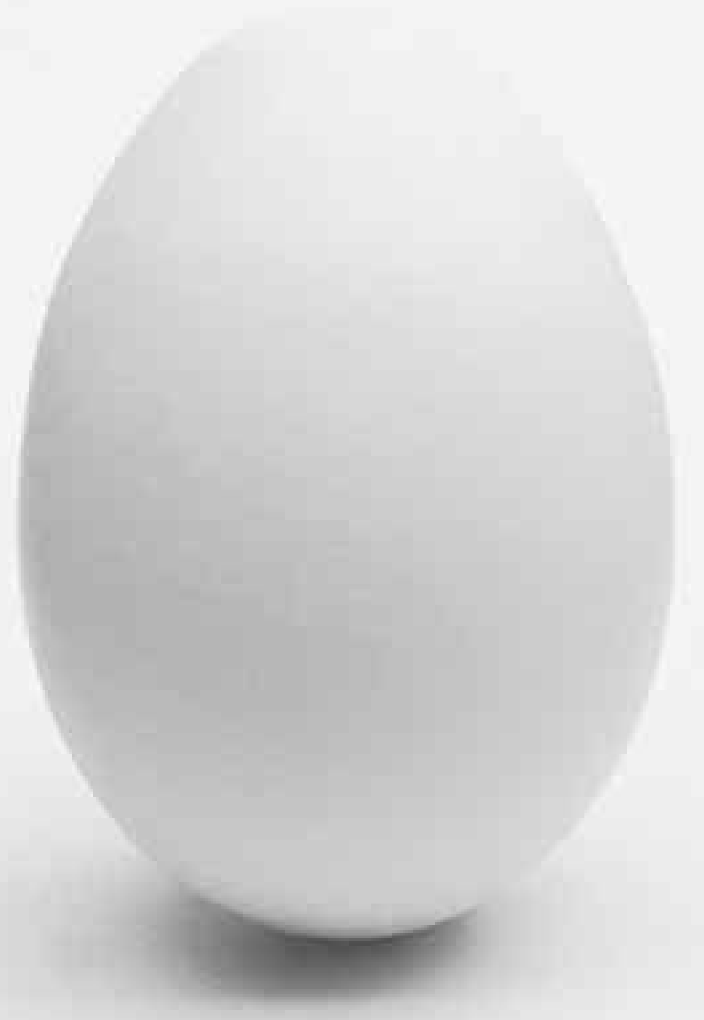
Australia's First Bank Short Report 1998

Understanding banking today…




will pay dividends tomorrow.

Westpac Banking Corporation
ARBN 007 457 141

This year was another year of solid progress for Westpac. But our industry continues to attract heated public criticism and debate. There are no rights and wrongs, just differing viewpoints. All of them valid depending on your perspective and the facts you have to hand. How we bridge the gap with our communities will fundamentally influence our future success. In this report we attempt to weigh up and simplify some of the biggest and most common issues facing banks today. These revolve around self-service electronic banking versus face-to-face services, and profits versus lower fees and social responsibility. We believe that by acknowledging criticisms and encouraging better understanding of the banking environment, our customers, staff and shareholders will all be better able to work with change, to understand it and turn it to their advantage.

Merger approved

November 1997

Westpac and the Bank of Melbourne merger is approved and planning for the integration of the two banks in Victoria under the Bank of Melbourne brand begins.

Award winning centre

November 1997

Westpac centralises its NSWback-office services, relocating around 1,000 staff into its new award winning Service Centre in suburban Concord West, providing staff with benefits such as on-site child care and easy access to transport.

FAI third party first

March 1998

FAI becomes the first third party to use The Mortgage Company for mortgage servicing. This allows FAI to focus on marketing and origination while achieving considerable cost savings.

Security first

June 1998

As part of its securitisation program, Westpac completes a US$1.4 billion global bond issue, a first for an Australian company and a good illustration of the innovative approach that won Westpac *Euroweek's* 'Outstanding Financial Institution Borrower 1997' title.

All in the family

July 1998

For the second consecutive year Westpac wins a silver award in the *Australian Financial Review*/Australian Chamber of Commerce and Industry Corporate Work and Family awards for its work environment which includes paid maternity, paternity and adoption leave, mutual negotiation of hours by part-time staff, and home-based staff.

EDA partnership

July 1998

Westpac's new Employee Development Agreement becomes effective up to December 2000, with competitive remuneration benefits, and allowing greater employment flexibility for staff.

Power to the Paralympics

July 1998

Continuing its history of involvement with Paralympians, Westpac becomes a national sponsor of the Sydney 2000 Paralympic Games. As part of the sponsorship, Westpac will provide banking services, with its staff acting as volunteers during the Games. Under the Paralympic Employment Program, Westpac employs five athletes, including Amy Winters, Paralympic gold medallist.

Millions nowhave say with BPAY

July 1998

Since its introduction in September 1994 and with the launch of new services such as BPAY in November 1997, the popularity of telephone banking continues to grow, now exceeding 3 million inbound calls and 5 million transactions per month.

Win, win, win

July 1998

In the *Personal Investment* 'Bank of the Year' awards, Westpac wins three gold, three silver and seven bronze awards, continuing its record of success, having been named 'Bank of the Year' twice and runner-up once in the three years before. Westpac's foreign exchange, capital markets, corporate banking and transactional banking services to institutions continue to win awards around the world.

Kiwi merger complete

August 1998

Two years, over 1,600 projects, 1.3 million customers and the WestpacTrust integration is completed, creating one of New Zealand's leading financial services organisations.

Westpac online first

September 1998

A KPMG survey ranks Westpac's Internet banking service (introduced in June 1998) equal first in Australia for its online banking capability, download speed, usability and technical design.

www.westpac.com.au

Tickets to the games

September 1998

214 customers have won tickets to the Sydney 2000 Olympic Games through the Westpac Reserved Seating Program.

Will a stronger customer focus pay dividends?

As part of our determination to position Westpac around higher quality, lower risk earnings streams, we have moved to a stronger community and customer focus. We see the development of deeper, multiple product relationships with our customers as critical to building longer term shareholder value. We are confident that our customer focus will prove to be correct in the longer term.
John Uhrig discusses how.

Australian banks have been faced with a new challenge this year as the global economy, sparked by the severe Asian recession, started to show signs of strain. Despite this, Westpac has continued to progress steadily on its primary objective of building long term shareholder value, and although a challenging year, its conservative approach is paying dividends in more ways than one.

Our strategy to achieve this has six main features:

- investing the bulk of our talents and financial resources only in markets we know well, that is principally Australia and New Zealand;
- investing continually in our people;
- deepening our community involvement in those markets we serve;
- pursuing lower unit costs by creating more efficient in-house service platforms, and by out-sourcing where we don't have scale;
- bundling products in ways that will interest our over seven million customers in terms of price and value; and
- maintaining sound risk and capital management disciplines.

Against the background of volatile financial markets and continued intense competition in Australia and New Zealand, our net profit after tax (before abnormals) reached a record high of $1,342 million, up 4.0% on last year. Despite the temporary dilutive impact of 142 million shares issued to Bank of Melbourne (BML) shareholders and the 80 million preference shares converted during the year, our earnings per share (before abnormals) was up fractionally to 70.1 cents. Reflecting this dilution and the impact of increased goodwill from the BML merger, return on ordinary equity at 15.5% was down from 17.0% last year. After adjusting for the impact of goodwill, however, tangible return on tangible equity was 21.5% (up from 20.9%), continuing the improvements of recent years.

Reflecting this solid profit performance, the Board has declared a fully franked dividend of 43 cents per ordinary share, an increase of 10.3% on last year's dividend.

In the five years since September 1993, Westpac has gone from a market capitalisation of around $7 billion to achieving a market capitalisation of $17.6 billion as at year end. Dividends have increased in every six months during the same period, and the compound annual return for shareholders (assuming all dividends were re-invested) has been 24%. In each of the past four years, Westpac has continued to produce record pre-abnormal profits. Our key objective is to continue producing good returns for shareholders.

Importantly for shareholders, asset quality continues to remain strong with net impaired assets declining by 8% to $490 million. Westpac continues to be prudently provisioned, with total provisions now equal to 188% of impaired loans.

Having established a solid foundation on which to build future earnings performance, we continue to pursue improvements actively across our businesses. Hence, our major investment in skills development and training to build the confidence of staff, and to equip them to maximise the effectiveness of the service tools now available to them. Continuing to build the confidence and skills of our staff is critical to our success in becoming a more community and customer friendly organisation.

We also continue to invest heavily in our service delivery infrastructure to provide more cost-effective solutions for our expanded customer base. To accelerate the reshaping and modernisation of our branch network, we have taken a $51 million charge as part of a net $70 million abnormal in this year's results. This will allow us to undertake an extensive program of improvements to our service network, including the introduction of new in-store and dedicated home loan branches, and refurbishment of existing older-style branches. The overall magnitude of this infrastructure investment program could be as much as $300 million.

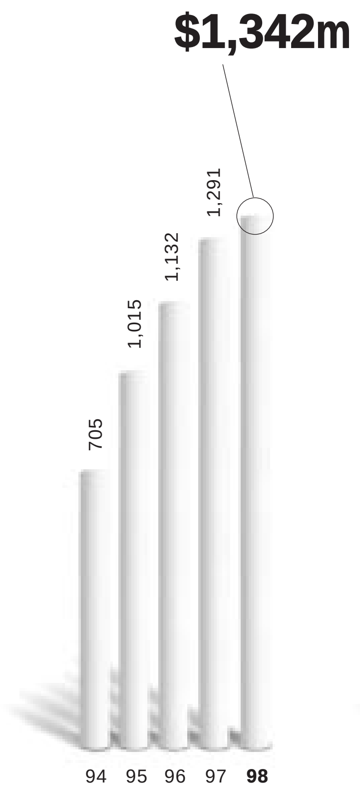
Westpac continues to maintain a strong capital position, with a Tier 1 capital ratio of 6.8% at year end. This figure is well above the regulatory minimum requirement of 4%, even after buying back a further 131.9 million shares this year (representing 7.4% of shares on issue at the start of the year).

Benefitting from our strong capital position, we have continued to manage our balance sheet actively to enhance returns for shareholders. During the year more of our housing loan portfolio was securitised. In June another first was achieved by successfully placing in the USA market a US$1.4 billion bond issue backed by a portfolio of Australian home loans. This was the first ever securitisation of foreign mortgages in the USA and brings us to over $7 billion in total securitised assets to date. This would not have been achieved without our investment in the Mortgage Processing Centre, which continues to allow us to lower the cost of servicing mortgages. Securitisation improves our overall balance sheet mix, while improving liability management and freeing-up capital for redeployment to higher return businesses or return to shareholders.

Westpac's strategic mergers continue to enhance its customer base and strengthen its community focus. During the year we completed our merger with Trust Bank in New Zealand. WestpacTrust is one of New Zealand's leading financial services organisations with 273 branches, 402 ATMs, nearly 19,000 EFTPOS terminals and more than $23 billion in assets.

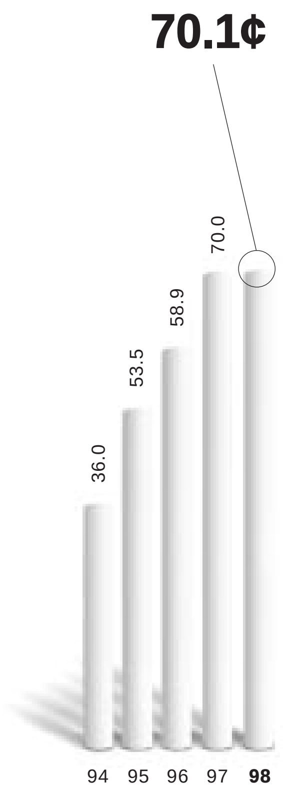
In Australia, our decision to adopt the public branding of our merged banks is supporting our community and customer focus. Challenge Bank in Western Australia was the first in this strategy, where we combined national strength with regional focus. Our integration of Westpac's Victorian retail operations with the Bank of Melbourne is now nearing completion, and we are confident the new Bank of Melbourne will prove to be a successful, customer focused competitor in the Victorian market.

Current policy prohibits major bank mergers although there is market speculation that this may change. However, any policy change depends on the attitude of the Commonwealth Government and regulatory authorities. It is important not to be distracted by this market speculation and instead continue to focus on improving the quality and profitability of our organisation.



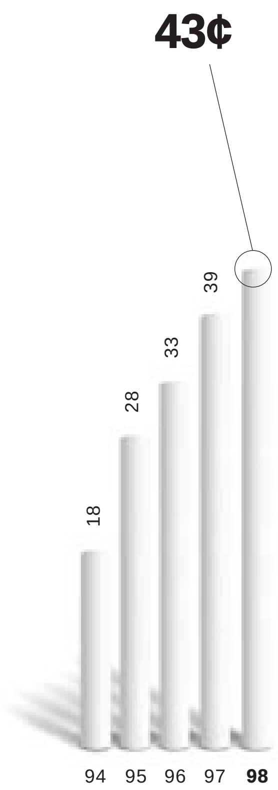
Profit

Operating profit after tax and before abnormals attributable to shareholders up 4.0% to $1,342 million



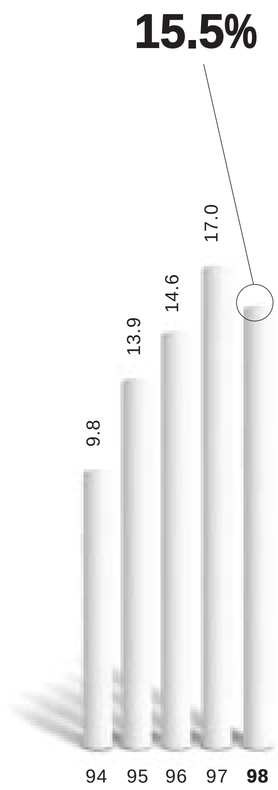
Earnings

Earnings per ordinary share before abnormals up 0.1% to 70.1 cents



Dividends

Dividends per ordinary share up 10.3% to 43 cents (fully franked)



Return

Return on average ordinary equity before abnormals decreased to 15.5% from 17.0% in 1997

We now have over seven million customers, a combination of Westpac's historic customer base plus those joining from our mergers. This broader base provides our staff greater opportunities to widen the product holdings of our customers.

We have already seen benefits from this. Our strategy to capitalise on the linkages between our frontline staff and the 480 Westpac Financial Services planners and advisors has had a strong result. Perhaps the best example is that in the year to June, Westpac had the largest net inflow of retail funds in Australia, with $1.8 billion of new funds under management from throughout Australia.

The impact of the Asian recession and subsequent global economic slowdown is yet to be fully felt in all our markets. Fortunately, Westpac's decision to reduce its Asian exposure over the past five years is proving to be judicious. We have been refocusing our involvement gradually since 1993 around servicing Australasian customers and trade flows, by selling our joint venture bank in Indonesia and finance companies in Thailand and Malaysia, selling our branch in Taiwan, and closing our Korean branch.

While we have minimised our direct Asian risk, our strategic relationship with Standard Chartered Bank is giving our customers unparalleled coverage and service in doing their banking in the Asian region. We will continue to manage our residual Asian exposure by running our business conservatively.

As a result, Westpac ended the year largely unaffected by the losses suffered by some banks which have arisen from exposures to emerging markets. At the same time, the global banking sector is still facing one of the toughest operating periods in almost a decade as the global economy slows, asset quality diminishes and fears of a global credit crunch increase.

Nobody in Australia and New Zealand will be immune from the impact of any global slowdown. While some industries are seeing growth, our customers, shareholders, staff and Westpac itself will be affected in varying degrees. As a financial institution with a foundation of sound risk management and dynamic provisioning, Westpac is well positioned to support its customers and deliver for its shareholders through this difficult economic period.

Westpac's efforts to lower costs, generate quality assets and prudently manage risk are aimed at setting us apart from our competitors in the short term. Our objective to deliver better solutions for customers should set us apart in the longer term.

In closing, I would like to take this opportunity to thank Westpac's staff for their consistent commitment to our key objective of servicing customers, and providing our shareholders with a solid return.

As we approach the new millennium and watch the extraordinary changes occurring in global financial markets, we recognise that competition in providing financial services will increase. Your Board is confident that Westpac's strategies and operating philosophy will hold us in good stead in the years to come.

The community's perceptions of banks are increasingly being tested by change. Bridging the gap with the community about what is happening with banking, and why, is fundamental to the ongoing success of banks. **Bob Joss** discusses the big issues facing banks today and what Westpac is doing about them. ➥

What is really going on with banks today?

Times are challenging for most of us, with our comfort zones being tested at every turn. Change is touching us all, whether it is through seeing our workplaces and jobs being redefined with new technologies, or through having to adjust to new ways of communicating, shopping or accessing services.

Nowhere is this more evident than in banking and finance, where the pace of change continues to accelerate. That is why we have chosen to take a positive approach, welcoming and building on the opportunities that change brings.

But we also recognise that change can be disturbing for some. Across Australia and New Zealand, many feel pressured into doing their banking differently. And some customers' branches have closed or changed shape because their community's population and business base has declined. Let me stress, however, that banks are almost never the first to leave these communities. Normally they are the last major business to close. In rural communities, particularly, these closures often draw heated public reaction because they confront the community's perceptions of their own town's future.

Partially as a result of these branch closures and the way banks are changing and charging for their services, perceptions of banks are not always positive. I also recognise that if we had taken more time to fully explain the forces driving the changed banking experiences today, these views would be more balanced.

It is now our challenge to alter these perceptions, by communicating more openly with the community and airing the facts, so debate about our industry can be more informed.

I recently toured Australia to talk with shareholders, many of whom are also our customers. I heard your comments and understand the depth of your feelings. Many spoke positively about the way Westpac is changing. But equally, some felt our service aims were platitudes, that our goal to hold onto customers' problems until fixed, for example, had not fully percolated to our frontline.

As I said at the time, I recognise we are not there yet. What I do know is that we are making progress. I know this because we get out regularly among staff and customers, and we measure our service success.

We are finding better ways to help our customers discover the real positives of modern banking developments. It includes our recently announced decision to spend potentially as much as $300 million to modernise and reshape our Australian branches, as well as our seven day, 24 hour telephone and internet banking services from anywhere in the world and our mobile lenders and advisors who put our customers' schedules ahead of theirs. And it includes our business overdraft package that integrates PC and telephone banking and card transaction services to allow businesses to better manage their cashflow, to name just a few.

I hold onto our goal of ensuring our customers feel they are in the driving seat. This is a major challenge for us all, but I am determined it will happen. Banking is no different from any other service industry. The only way to generate repeat business, more business, is to ensure our customers have a professional and personable experience every time they have contact with us. When our staff consistently provide that experience and resolutely find solutions to help them through challenging times, we will make steady inroads.

Where this has happened, our customers have been enthusiastic. In a recent telephone banking case, a customer phoned with a problem at the end of a staff shift. Our employee could have gone home. But she thought: 'How would I feel if this had happened to me?' So she stayed on, resolved the issue, and was able to phone the customer at 10pm with the solution. The customer was overwhelmed. These positive situations create mutual benefits. Every one of those positive customer responses helps build our staff's confidence and increases their understanding. And when I see this happen, I know we can be different from our competitors.

Most banks talk about building shareholder value. But talking about it is one thing – truly understanding what drives it, and making decisions that provide the best long term return for shareholders, is another.

We believe there is one sure way to build sustainable shareholder value. It comes from having satisfied customers using more of our products more of the time.

But how do we achieve this? By ensuring our customers' experiences with us are so impressive, they think of us first for their new financial business and willingly come back for more.

Ultimately it comes down to us understanding our customers better, taking ownership of their financial needs, and being committed to delivering better solutions to them. It will only come from our staff grabbing hold of our customers' issues and not letting go until they are resolved.

Westpac has seven million customers, 40% more than six years ago. Our effort to increase our customer base has worked. Now we want to deepen our relationships with our expanded customer base.

Only then will we be able to drive down unit costs as we get the scale benefits from putting more business through our improved distribution and centralised support sites.

As a result, we will increasingly be able to offer good value to our customers based on the expanded value of their business with us. And that will create a win/win for everyone. It will help build shareholder value.

Put another way, the real path to creating further shareholder value is to develop our staff to be more committed to delivering better solutions for our customers and shareholders.

I believe we are leading the way in some important areas. We are starting to take a more integrated approach to our relationships with individual and business customers and, with support from our modern service centres, are providing them with better solutions every time they come in touch with the bank.

Despite our progress, I recognise many customers and some shareholders still think we are ignoring the real concerns the community has about banks. This is far from the truth.

What we can and are doing is listening to our customers and the general community much more than ever before. We are better understanding how our customers feel, and are working on creating more positive experiences for them.

In particular, we are being more sensitive to those who are either unable or, at this point unwilling, to embrace change. Where it is possible, we are providing customers with a choice: to stay with the familiar, to embrace the opportunities presented by technology, or to combine the old and new in meeting their banking needs.

Part of getting there is for all of us – staff, customers and shareholders alike – to have a better understanding of the key issues dominating the debate about banks. It is about gaining a truer perspective – looking through fresh eyes, if you like.

We want to promote this better understanding of the key issues facing our industry.

That is why I am taking a different approach in my report. Instead of telling you about our achievements by division, which are covered in the financial review section, I am devoting the following pages to airing the big questions the community has about our industry, and responding openly from Westpac's perspective.

After all, bridging the gap on these issues, helping create understanding on what is happening in banks today, is fundamental to building value for our shareholders.

Why shouldn’t there be a bank branch in every town?

Because there should be one in every home.

A bank branch in every home is not pie in the sky. It's pretty much a reality. For some years now, most banking services have been as close as your phone – 24 hours a day, seven days a week.

You don't need a computer, don't need an internet connection. But with them, your virtual home branch becomes even more real with printed statements and account information on screen. ➥

But even with our $100 million-plus investment in providing electronic banking services, we recognise some customers are still not happy. Many see the move to electronic banking as our way of reducing face-to-face contact, see it as a symbol of us abandoning the bush, see it as a way to generate more fees without providing real service.

Many reject the new ways of banking because they don’t fully understand them, don’t know how to use them, or simply don’t want to.

Some customers, particularly, prefer face-to-face branch banking. As one shareholder told me: ‘I’ll never use telephone banking. I don’t have a reason. I just don’t feel comfortable with it.’

But others are seeing real benefits from these new ways of managing their finances. As another shareholder told me: ‘After many misgivings and much grumbling, I finally succumbed to telephone banking, and now I’m an enthusiast. One result is I’ve rarely set foot in a branch for the past 12 months.’

And that’s the rub. Most who try these services wouldn’t return to the old style of banking if you paid them. They welcome these new ways of doing business with us.

We recognise the way forward is about getting the balance right. This is not about reducing face-to-face contact. Our challenge is to continue providing progressive, technologically-driven services without losing sight of the comfort levels our customers feel with ‘people-based’ services.

It’s also not, as some would suggest, about abandoning the bush. It’s about finding ways to continue providing banking services where it’s no longer viable to run traditional large branches in every town.

And it’s not just a way to generate more fees without giving real service. It’s about providing better service and greater convenience at lower costs. Electronic banking provides benefits of scale. The more it’s used, the more cheaply we can provide it, thus creating a win/win for both the bank and our customers. It is many times cheaper to provide electronic banking than over-the-counter service. That means customers using electronic banking generally pay less in fees than those using the old ways. And it can provide very personalised service if customers need it. Telephone banking has real, live Westpac people available 24 hours a day, 7 days a week.

The fact is that self service banking is the financial industry’s response to changing lifestyles and customer needs. We know that more and more people are using EFTPOS, ATMs, Telephone Banking, the internet, BPay, credit and debit cards. Today, around 80% of Westpac’s transactions are done electronically.

People aren’t using these facilities because they have to. They’re doing so because electronic banking provides the most convenient way for them to manage their finances.

We recognise there will always be a need for customers to personally discuss financial management issues, which is why we have about 1,000 mobile staff who put customers’ schedules before their own.

Something else we’ve recognised – something really important – is that, for the most part, our customers don’t so much resent the changes, they just feel they weren’t consulted about them.

So we’ve been doing something about these concerns. First, we’re putting educational programs in place to help our customers understand and use alternative banking methods with ease and confidence.

Second, we’re working with rural communities and introducing in-store branches in pharmacies, general stores and newsagencies – an Australian first – because we recognise telephone banking can’t provide cash or cheque clearances. Wherever we currently have a face-to-face presence within a country town, our intention is to maintain it with either the existing branch or a new in-store branch.

And third, we’re meeting with customer groups to explain the very real economic factors driving our decisions. We’re taking the opportunity to listen to our customers so we can continue to provide services that work for them.

Let me talk about our branches. There are very few companies who have 1,000 or more stores in Australia. I can’t think of many other industries that have as much convenience and access to their services as banks provide.

The branch network changes that have occurred are a symptom of the issues facing rural Australia, they’re not the cause. Throughout Australia, there are now 60% fewer petrol stations than 30 years ago, 44% fewer new car dealers than 20 years ago, and 70,000 fewer government jobs outside the capital cities than in 1986. Where banks are different from many other businesses leaving country towns, is that they are investing in finding real ways to provide the same services through alternative facilities.

We can’t hold out against change. We’re looking to find a balance with solutions that are more clever and flexible than ever before. Solutions that serve both our industry and the community we’ve served for 181 years, and will continue to serve. We want to provide new ways of banking that can really make a positive difference in our customers’ lives.

It’s a continuing challenge. But we’re embracing that challenge with enthusiasm.

But aren’t all banks the same?

Maybe, but the people who work for them aren't.

A major problem with banks today is that the public sees no difference between them. As one of our institutional investors said recently, 'We see a red one, a blue one, a yellow and black one, and a black and red one. Apart from that you all sound the same.'

To a great degree they're right. With advances in technology, the speed that banks can match each other on products and pricing is faster than ever before.

But there's a fundamental element which can't be so quickly replicated in delivering financial services. And that's the skills and commitment of staff and the quality of their work environment. ➥

The fact is, our industry is undergoing rapid change. Entry barriers into financial services have lowered dramatically. Product blurring and regulatory initiatives have changed the competitive dynamics. Technology and distribution are being globalised and ideas and capital have always been global.

It’s an ongoing challenge to ensure we’re better than our competitors. Our strategy for success is based on Australia and New Zealand and on delivering better solutions for our customers. Unlike some competitors who are focusing on global expansion, or being the low cost producer supplying only a few products, we’re focusing on the markets we know best and on our customers’ relationships with us.

In the service industry, the only real differential is the quality of interaction customers have with the people who serve them. It’s the people and the information they have which makes the competitive difference.

We know our customers don’t perceive us to be different enough yet. But we are determined to be different, determined to be better, and we’re investing a great deal of time, money and strategic energy on developing that difference right across Westpac.

We know that to be more successful we need more of our customers’ business. We know customers will only choose us more often if they have positive experiences every time they’re served, if our people grab hold of their problems and give them better solutions.

So how can we ensure every one of our people is committed to making every customer experience a positive one? How can we keep our staff motivated while still driving down costs?

We can do it by creating workplaces our staff can thrive in, where they can run with the ball and feel a sense of achievement when they provide innovative customer solutions. And workplaces where teamwork, customer focus and integrity are championed every day. We can do it by creating flexible jobs which allow quality time outside work. And we can do it by being an organisation our people can be proud to work for.

That’s why Westpac provides a level playing field for our staff. We are a meritocracy. When employing people we’re only concerned with a person’s ability and willingness to do the job well. If you’re the best candidate for the position, you’ll get the job.

Around 70% of our staff are women. At one shareholder meeting I was asked if that percentage was reflected across all levels of Westpac. Let me tell you, we have a strong philosophy of pushing equal opportunity just as fast as we can because we believe our people in management should reflect the diversity in our staff and our customer base.

In our manager category, about 31% are women (61% of branch managers are women) and that’s steadily climbing. Of our senior managers – the top 60 or 70 people in the bank – 13% are women, and that group is also growing. So while we don’t have 70% of women across the board, it’s a lot better than at any other time in our history.

Our staff appreciate the approach we’ve adopted in their workplaces. They’ve told us they enjoy the multi-skilling. They enjoy the more fluid and less bureaucratic way their work is developing. They feel particularly good when given discretion and responsibility to serve our customers well. And they recognise that more customer business means a more secure future for them.

And it’s starting to work for us. We get out and talk with our staff. I’m heartened that a clear majority of our staff are on side and confident of the future. I know we’re on the way.

Our staff are also demonstrating their commitment to making Westpac a great Australian company by participating as shareholders. Today, around 50% of our Australian staff are shareholders.

One of our big challenges is to ensure we continue to adapt the skills base and composition of our staff, in line with the changing requirements of customers and the way products are distributed.

That has meant we have needed to review aspects of our staffing and distribution. As a result, we have fewer staff in some areas than we had in the late ’80s. Most noticeably you see fewer staff in branches today because they’re now doing many different jobs; jobs as mobile sales staff, jobs in technology, in state-of-the-art service centres, in telephone banking. And we’re creating new jobs in regional centres. We’ve just opened a new telephone banking centre in Launceston which will ultimately provide 200 jobs. This is in addition to the 1,600 jobs we created by locating our Mortgage Processing Centre in Adelaide.

At the same time, the pace of change is quickening: while nobody can predict exactly how financial services will evolve, one thing we can predict is that our customers will be more demanding and will want us to deliver better, faster and cheaper solutions to them than ever before.

Our people, therefore, need skills to be flexible, faster on their feet, good at teamwork, and be able to grow with banking as it evolves and changes. We’re investing in developing these skills because we want our people to be better skilled than those in other financial institutions. We want them to be different.

We recognise that unless our people are different, and our customers’ feel that our staff are different, they won’t necessarily give us more of their business.
I believe we’re on the way to achieving that differential.

Why are bank fees going up?

Because everyone deserves a fair deal.

When customers deposit their money with banks they're effectively making a loan to the bank, so it's not unreasonable to expect banks to pay them a fair rate of interest in return.

When banks provide transaction and other services to customers there is real value provided and substantial costs involved, so it's only fair for these costs to be met by those who use the services.

That's why we charge customers for the transactions and payment services they use and why we pay our depositors a competitive market rate for the funds they lend us.

Why then is there so much community outrage over bank fees? ➥

Perhaps it's because for so long many banking services were seen as 'free'. But they were never really free.

The real costs of providing services were simply covered by hidden cross-subsidies. Depositors were generally paid a less than fair rate for their deposits, and borrowers charged more for their loans to make up for the services that were provided free to others. Despite this being neither fair nor equitable for customers, it was the accepted way.

Banking deregulation in the early 1980s threw that to the wind. When the doors to providing financial services were opened, the way the market operated changed. Competitors who only made loans and competitors who only accepted funds for savings or investment, did so at interest rates that didn't have to cover the cost of 'free' transaction services. Customers increasingly voted for these lower rate loans and higher rate deposits.

Consequently, bank transaction accounts could no longer live off 'hidden' cross-subsidies in this competitive environment. As a result, fees have been progressively introduced and the inequities of cross-subsidisation reduced. Failure to do so could have impacted the viability of banks and the banking system itself.

Although some customers are not comfortable with being charged for banking services on the basis of usage, it's hard to argue that it's not only a much fairer system, but also the only way to provide competitive rates for bank loan and deposit customers.

But we have some hurdles to overcome before there's broad community acceptance of fees. One major hurdle is that, because many transactions were free for so long, the public has little appreciation of the true costs of providing these services. They believe banks are simply boosting their profits.

Just think what goes on when you use an ATM or pay your supermarket bill via EFTPOS. By swiping your card and inputting your PIN, your account is accessed in seconds via an electronic signal. If funds are available, your transaction request is approved, funds are transferred, and the whole transaction is accurately completed and fully recorded. All this happens within seconds for the customer's convenience. And while it is cheaper to provide than many traditional branch services, there are still obvious and substantial costs involved.

You may be surprised to learn that it typically costs a financial institution about $100 per year to support an active transaction account. So, if a customer's balance is say $500 and there are no transaction fees, the bank is paying the equivalent of 20% annually, even before paying any interest on the deposit.

The 1997 Financial System Inquiry Report (FSIR) recognised this quandary. It stated 'As more and more customers maintain transaction accounts with only working balances, net interest income declines, forcing the institution to rely more heavily on fee income.' In other words, in order for banks to continue providing fair and equitable transaction accounts for all customers, it's imperative we recover some of the transaction costs from users of these accounts.

A further hurdle is that most people have little understanding of the cost difference in providing face-to-face and electronic services.

As the FSIR recognised, 'The prices paid by individual customers are likely to be more differentiated than at present, depending on the range of services they use, the frequency of that use, and the channels through which they seek to have those services delivered.'

Even when customers accept the need for fees, many still question why they keep rising. The reason is that while we are bringing down our unit costs, our current charges simply don't yet cover the cost of providing these services.

This was acknowledged by the Prices Surveillance Authority in 1995, when it found that Australian retail transaction accounts recovered less than 15% of the cost to service those accounts. This recovery rate has increased towards 50% in the past three years.

Like other Australian banks, we recognise that we can't move to full cost recovery in the short term. The community simply needs time to adjust.

So that's why we're providing a basic level of 'fee free' banking to all Australians and giving customers alternatives and time to change their banking behaviour to minimise fees.

One way is for customers to increasingly use the more efficient and convenient electronic services. Not only are electronic services cheaper for customers to access, they provide greater control and convenience. And customers are responding.

It's important to stress that our customers really do have a choice about their bank fees. We advise customers about our fees via letter, brochure and the internet. We show account comparisons. We provide tips on how to reduce costs. Our Smart Banking brochure, for instance, informs on ways to reduce charges across a range of services. We believe in giving our customers a choice in whether to pay more for face-to-face access, or less for electronic access.

Westpac knows its customers are not captive. We have to earn their business by giving them better solutions every day. I can assure you we will only earn their trust if they believe they are paying a fair and equitable user charge for their transactions and banking services.

Like all other businesses, bank fees are linked to costs. Our challenge will be to aggressively contain costs, while finding better and more efficient ways to deliver banking services to customers. We believe we're up to the challenge.

Who says banks have
a social responsibility?

‘We do.’

Banks have always played a major role in society. They have a particular social responsibility to ensure they are well-run – making loans and accepting deposits in a manner which contributes to a safe and sound financial system so essential to all national economies. Beyond that, the community rightly considers that banks have a duty to contribute to society as a whole. We agree. ➥

As the global economy shows signs of strain, sparked by the severe Asian recession resulting from poor banking practices, the key responsibility of banks to play a pivotal role in ensuring a safe and sound financial system has come to the fore even more.

Our customers in Australia and New Zealand have been well served in this regard, with a continued safe and sound financial system in both countries.

In the long run, Westpac will only be as strong as the communities we serve. We therefore have a responsibility to ensure that the large investment of our shareholders is used in prudent ways to support and make the community stronger. This includes maintaining rural branch representation which, relative to customer numbers, is some 50% greater than in metropolitan areas, which recognises the special needs and more limited access to financial services of our rural customers. And it includes our responsibility to manage the community's savings and capital entrusted to us, intelligently and safely.

As we have moved to re-invigorate our historically strong community focus, we have sought to develop a better understanding of the broader community's changing needs and how we might better contribute.

Our great difficulty is in deciding, on behalf of our over seven million customers and 172,000 shareholders, who, among all the discerning social service providers, should be our community partners. We've started in Australia by taking an innovative approach to this by having our staff – as mirrors of their own communities – tell us where to direct Westpac's community funds. The Managing Director's Community Service Awards are an example. In the past six years, through these awards alone, we've donated more than $350,000 to organisations where Westpac staff volunteer.

Our staff support goes beyond this. We provide paid time off work so they can pursue their charitable interests. We encourage direct salary contributions to causes of their choice. And Westpac, itself, contributes funds to these groups in turn.

I'm very proud of Westpac staff's contribution to the community. With the bank's support and encouragement, more than 33% are already active in community service through our Community 2000 program. For the most part the rewards they receive are intangible. But their community service track record could see them being selected as volunteers for the Sydney 2000 Olympic Games. And that's a bonus.

Encouraging our people's involvement – and putting our money behind their action – has broader community ramifications. By nourishing their community involvement, we play a part in their growth and development. Our challenge is now to bring more of our shareholders and customers into this gratifying loop and encourage their participation.

An additional aim of our focus on community partnerships is to create broader long-term mutual benefits for non-profit community organisations. With input from potential participants, we recently commissioned a 'Financial Management Training Program' from the Macquarie Graduate School of Management. This brought together senior executives from 20 non-profit organisations to help strengthen their decision-makers' financial management skills and teach them practical, innovative ways to make the most of their organisations' limited resources.

This partnership – along with our long-term involvement with the Westpac Mathematics Competition, our support of The Australian Council of Business Women and Young Achievement Australia – is an example of delivering tangible and lasting benefits.

Such support follows the old adage: 'When someone is hungry, don't give them fish, teach them how to fish'. It enables us to add lasting benefits to a variety of community concerns, instead of making one-off cash donations to just a few. The Maths competition, for example, encourages numeracy in the community and ultimately helps develop Australia as a clever country.

Even with this focus on developing mutually beneficial partnerships, we haven't forgotten our traditional support. We still directly help community organisations such as the Fred Hollows Foundation, Salvation Army, and United Way. And we make our extensive branch network and telephone banking operations available to communities in crisis, as well as organisations such as the Children's Medical Research Foundation, Juvenile Diabetes Foundation and Australian Breast Cancer Foundation.

We also value our opportunity to support the community through a range of sponsorships including the WestpacTrust helicopter rescue services in New Zealand, the Westpac rescue helicopters on the Australian east coast, and the Sydney 2000 Olympic Games.

And when the community comes out in force to Clean Up Australia, our staff play a leading role.

Westpac is a company that accepts its social responsibilities. Although we benefit – commercially, ethically, and from our staff's personal development – the community benefits in the broadest sense.

And I can't think of a better reason for us to continue creating more of these win/win partnerships. After all, Westpac is a large part of the communities in which we operate and we readily accept our role in enhancing the social fabric of the nation.

Is making money good for the bank?

No, it’s good for the community.

There are many myths about bank profits, not the least that they fill shareholders’ pockets to the detriment of bank customers. Sure, profits mean our 172,000 owners get a return on their investment. But that’s also good for the millions of Australians who have part of their superannuation invested in Westpac. ➥

However, the biggest pay-back when banks operate profitably is that customers can feel confident that their savings are secure and the community can feel confident that loans will be available to support economic activity. And that's vital for community well-being.

Healthy profits also provide the money for us to explore and develop progressive ideas and services such as our telephone banking, the Mortgage Processing Centre, our business banking centres and our mobile sales staff. More recently, our healthy profits have allowed us to begin the bold and exciting program to modernise our Australian branch network. While our customers enjoy added convenience, these new initiatives also help create new careers and a broader future for our people.

It's a straightforward truism that profitable banks go hand in hand with a healthy economy. When banks are unhealthy, they struggle to build and maintain the capital base they need to support their operations. In turn, this means their ability to finance the community and the longer-term growth of the nation is jeopardised. If that happens, communities invariably lose confidence in the banks, the financial system then grinds to a halt and the economy spirals downward until the banks are recapitalised and confidence is restored. Asia is a timely reminder that when bank problems hit the front pages, the whole nation suffers.

There is no way around it. Banks need a strong capital base to cushion against losses that always arise with economic downturns. And the most important source of new capital is the profits that banks retain. So it's vital for the community that their banks remain profitable.

But even when bank profits are accepted as both necessary and good for the community, many still question their size, asking “How can banks justify billion dollar profits and still feel the need to close branches or increase fees?”

Looking at the size of profits by itself is far too simple. Many people simply see a billion dollar profit as too much, regardless of a company's size. They may not appreciate that the bigger the organisation, the more customers it has, the more shareholder dollars it uses, the more assets its shareholders have at risk, and the more income it produces in absolute dollar terms.

Take Westpac for example. We are a healthy and profitable company, but our profits that are actually quite small compared to our size. At the end of September, our shareholders had invested $8.6 billion in Westpac and borrowed a further $128.7 billion, so they had a total of $137.3 billion invested and at risk in Westpac. And against this, our profit before abnormals was $1.3 billion. That is, we made less than one cent of profit on each dollar of the $137 billion of assets, which is about as low as any business sector in Australia. This means we have little margin for error in making loans. With a less than 1% profit margin, we have to be right about 99 times out of 100 when we make loans and we have to be right consistently. If we miscalculate, what seems to be quite a large profit is quickly transformed into almost no profit at all. And if that happens, the capital base built up through retained profits over the years then becomes absolutely crucial for customer and community confidence and health.

So not only do bank profits really need to be looked at relative to the size of the bank, there needs to be adequate profits to ensure the community's interests are safeguarded and the shareholders get an acceptable return.

At one shareholder meeting I was asked, ‘What comes first – fees and profit margins or the value of personal relationships?’ I think, as with just about everything else in our lives, the ideal is a balance. We need to charge fees that are equitable for our customers, that match the competition and cover our costs, while also providing a fair return for our owners, the shareholders.

You can't say which is a first priority. Our shareholder returns and the value of personal customer relationships are interdependent. In service industries like ours, you cannot substantially have one without the other. They are both equally and vitally important.

I was also recently asked, “What's the current score in the Australian banking market?” Well, it's very intense. We are reasonably happy with our competitive ability, but not as happy with our position. We'd like to be stronger in terms of customer satisfaction and shareholder profitability, and that means selling more products to the customers we have, and to do so at lower costs to the customers. That's important for us. And it's important to our customers.

We are now totally focused on getting our staff better trained and more customer-focused than our competitors, to deliver better solutions and increase our customer satisfaction ratings over other banks. This will maximise our chances of continuing to make the kinds of profits which not only provide a good return for our shareholders, but ensure we stay a strong and secure financial institution. One our customers can rely on to manage their funds well and our communities can count on for sensible financing support.

We're not at the top yet, but we're aiming there. Obviously being better in everything we do means we'll make a healthy profit, which in the end will benefit the communities we serve.

It's easy to talk about the issues, but what are we actually doing?

We're listening and acting.

Making bank services easier to use

- We have over 1,400 branches and other points of representation for over 7 million customers in Australia, New Zealand and the Pacific Islands. Many of these offices operate extended hours for the convenience of customers.
- We have embarked on a major $300 million program of branch network modernisation and refurbishment, including introducing further in-store branches and new home loan and individually themed branches.
- In country areas, we have introduced in-store branches in rural communities which allow customers to conduct their full range of banking transactions using a mixture of face-to-face service and technology, with longer service hours.
- Telephone banking operates 24 hours a day, 7 days a week enabling customers to do their banking (except for cash and cheque transactions) and other financial services from anywhere in the world at times convenient to them. Customers now do over 60 million transactions a year using the telephone.
- Customer Service Officers are available via the telephone at any hour of the day or night to respond to customer needs.
- Internet banking allows customers to see what is happening with their accounts, to make payments, or to view other aspects of their financial needs with a personal computer.
- Via credit/debit cards, our customers have access to a shared network of over 9,000 ATMs in Australia and over 200,000 EFTPOS terminals toaccess cash when they need it, and many thousands more overseas.
- We have about 1,000 mobile staff who can meet customers when and where it is convenient to them, to discuss their banking and financial needs and provide solutions.

Providing staff that can really make a difference

- Westpac is over 30,000 people, the majority living and working in Australia and New Zealand.
- Being representative of their communities, they are skilled women and men of all ages, all with the same objective: to serve our customers as part of a team delivering better solutions.
- The continuing change in financial services has seen many jobs change or disappear altogether. This mirrors what is happening elsewhere in the community. But there have been new jobs created that did not previously exist and which require different skills, e.g. over 600 in telephone banking in Brisbane, Sydney, Melbourne and Launceston, around 500 mobile managers and 480 financial advisors and planners, over 2,400 in operations centres and about 1,600 in the mortgage processing centre in Adelaide.
- Changes in community expectations have also seen a change in employment and work practices. Westpac has responded to these changes by implementing a number of family friendly workplace initiatives. These include paid maternity, paternity and adoption leave, flexible working hours, job sharing, home based work, and on-site child care facilities.
- We have changed from a hierarchical based remuneration system to one based on reward for performance, which recognises the contribution of each staff member, no matter what their position in the organisation. In Australia, 86% of staff voted in favour of the terms and conditions of the Westpac Enterprise Development Agreement when implemented in 1998.
- Around 50% of our Australian staff are shareholders.

Giving customers a fairer deal

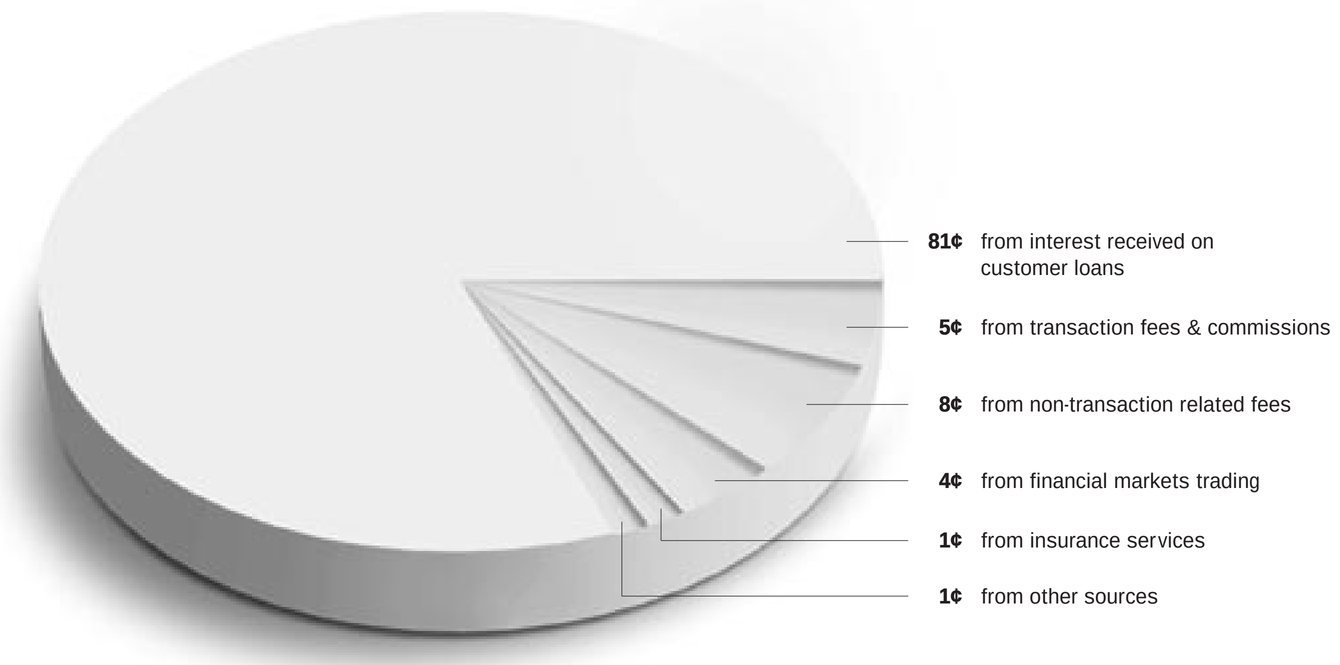
- Westpac has an award winning range of banking and financial services products. These are continually reviewed and revised to ensure that they meet customers' needs, and provide the best solutions for them. This allows customers to choose the product which best meets their needs and cost.
- The Smart Banking program initiated in late 1997 helps customers to review their needs, then select the best products to meet these needs, while giving tips on how to reduce their costs.
- Customers have the choice of a range of transaction accounts, from a basic fee-free account to the award winning Classic Plus account.
- Children and retirees are catered for by special accounts and features, including the Classic, Bonus Saver, Retirement Saver and Pensioner Deeming accounts.
- To help customers who find it difficult to understand or use systems such as telephone banking or ATMs, Westpac holds seminars or in-branch demonstrations at which staff help these customers to use the various systems available, and learn how they can do their banking quicker and at lower cost.
- Telephone banking Customer Service Officers can 'talk a customer through' transactions to make it easier and more comfortable.
- Rather than offering customers a 'take it or leave it' approach, staff work with customers to identify those products which provide the best solutions to meet their needs. They also follow up with the customers to ensure that they continue to be satisfied with the solution chosen.

Putting more back into the community

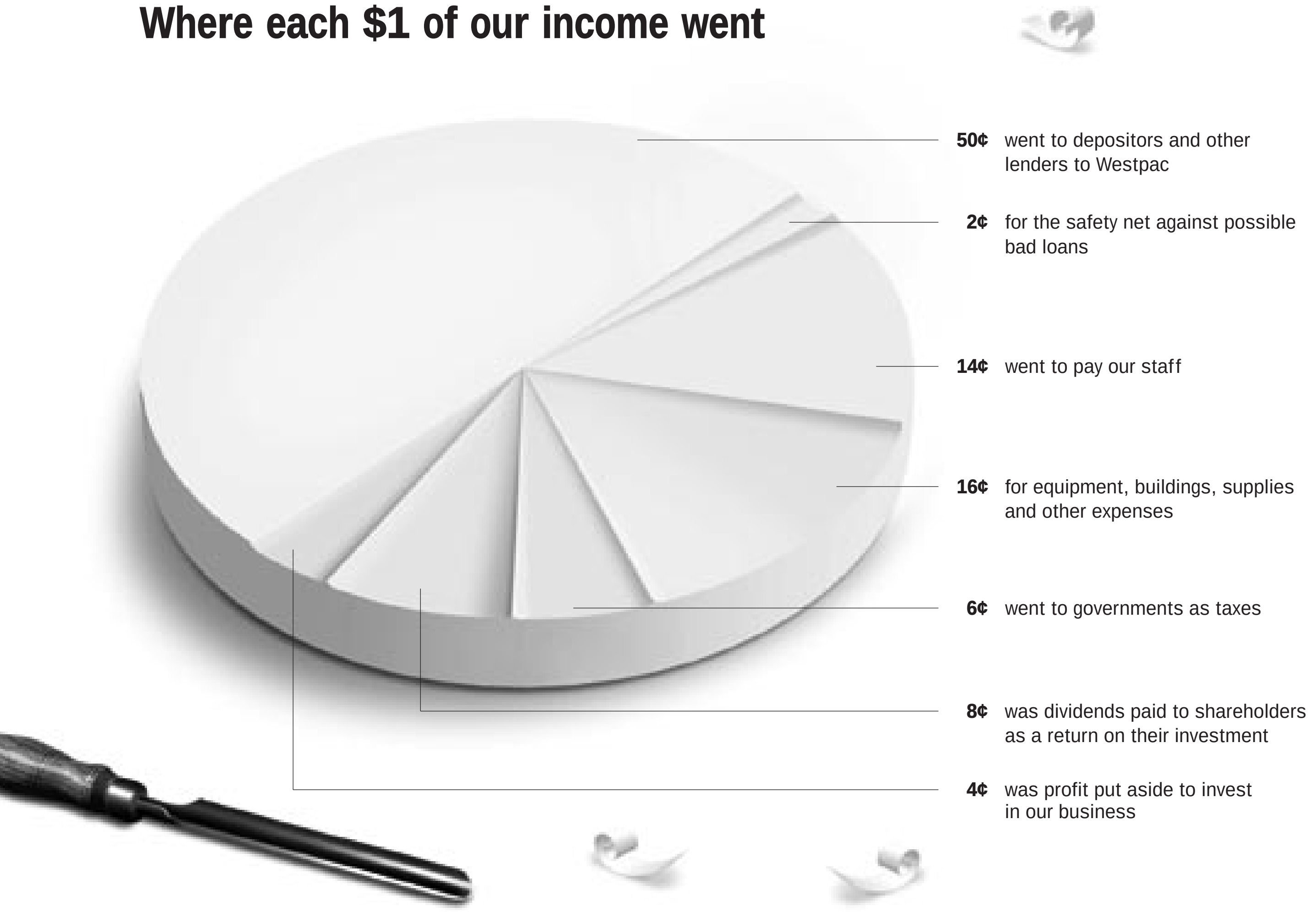
- Westpac staff have been involved in their communities for 181 years. But the way in which our staff are involved is changing.
- All staff have access to a community service day which gives them paid time off to use for their particular community organisation.
- With over 33% of staff volunteering, this amounts to at least 500,000 hours a year used to benefit community organisations.
- Westpac supports our staff's commitment through the Managing Director's Community Service Awards. In the past six years, over $350,000 has been distributed to various organisations in which our staff are involved.
- In addition to our staff's involvement, Westpac makes both direct and indirect contributions to community organisations. As well as direct donations, indirect contributions of in-kind support are made to various organisations for activities undertaken via our telephone banking or branch networks.
- Westpac develops community partnerships to create long-term community benefits such as through our involvement with the Westpac Mathematics Competition; our support of Young Achievement Australia, and the 'Financial Management Training Program' which we commissioned from the Macquarie Graduate School of Management to help strengthen the financial management skills of non-profit organisations.
- In July 1998, Westpac became a presenting partner of *'O' News,* a newspaper on the Sydney 2000 Olympic Games being distributed to over 3 million school children in Australia in the coming two years.

Putting profits in perspective

Where each $1 of our income came from



Where each $1 of our income went



Did you know?

The history of Australia's First Bank is as rich in pioneering history as that of the country in which it was founded in 1817. From goldmining boom to depression era bust. From the outback to the Olympics. Westpac Banking Corporation now operates in Australia, New Zealand, Pacific Island nations, and all major world financial centres. Always at the forefront of innovation, you would probably expect to find Westpac leading many technological breakthroughs. Along the way though, there have been many smaller, lesser heralded events – the little things that have gone into making up the big picture that is Australia's First Bank today.

Along the way there have been a few surprises…

No rest for the wicked. The Bank of New South Wales' first employee, Joseph Hyde Potts, took his first holiday 17 years after joining the Bank in 1817.

As part of the Greenhouse Challenge, Westpac is on target to achieve it's aim of reducing greenhouse gas emissions by at least 24,200 tonnes by 2000.

Our cover girl for last year's annual report, Susie O'Neill, holds the Commonwealth Games gold medal tally record as well as a swag of Olympic medals. We're sponsoring her for the Sydney 2000 Olympic Games.

In the pioneering 1860's, a goldminer visited his bank branch. Stepping inside the simple calico tent, he found a young assistant perched on a piece of bark resting on two logs with a stream of water running under him – the result of melting snow piled at the back of the tent. That's customer service for you!

The hard facts about our business

Total assets	$137.3 billion	
Australia	75.9%	
New Zealand	17.4%	

Customers	7.4 million
Australia	5.8 million
New Zealand	1.3 million

Personnel (FTE)	33,222
Australia	24,878
New Zealand	6,036

Points of representation	Branches	ATMs
Australia	1,091	1,431
New Zealand	273	402
Other	97	5

Market capitalisation **$17.6 billion**

The Westpac Group is in the top 10 companies ranked by market capitalisation on the Australian Stock Exchange. We have been listed on the Australian Stock Exchange since 1871, the New York Stock Exchange (ADRs since 1989) and the Tokyo Stock Exchange since 1986.

Shareholders **172,617**

With the majority in Australia.

In 1927, 110 years after its establishment, the Bank of New South Wales undertook its first merger with the Western Australian Bank.

Since then, we've been strengthened by 5 mergers, the latest – with the Bank of Melbourne – in 1997.

During WWII, American General Douglas Macarthur conducted court-martials in the board room of the head office at 341 George Street, Sydney.

Sergeant Jeremiah Murphy was the first person to open an account with the newly established Bank of New South Wales in 1817. A short-lived, although most content customer, he was also the first to close an account a few months later when he left the country.

Our business operations

Australian Retail Financial Services

	1998	1997
Profit on operations (million)	**$750**	$626
Total assets (billion)	**$68.9**	$55.7
Funds under management (billion)	**$19.3**	$15.5
Personnel numbers	**22,619**	19,330

Australian Retail Financial Services includes the Regional Bank operations branded *Westpac* in New South Wales, Queensland, South Australia, Tasmania and Northern Territory, *Bank of Melbourne* in Victoria and *Challenge Bank* in Western Australia, and the Australian operations of Australian Guarantee Corporation and Westpac Financial Services.

- Westpac won 3 Gold, 3 Silver and 7 Bronze awards in the 1998 *Personnel Investment* 'Bank of the Year' awards and equal first from KPMG Peat Marwick for the Best Internet Site.

Consumer Banking provides a full array of deposit, loan, card and transaction account products.

- Over 4.5 million customers spread across Personal Banking, Priority Banking and Private Banking.
- 1,091 branches, 1,431 ATMs (and access to over 9,000 ATMs in Australia), over 26,000 EFTPOS terminals and card access to over 200,000 of EFTPOS terminals.
- Telephone banking (1.8 million customers) and internet banking (over 20,000 users in first three months).
- Credit cards (1.7 million cards on issue).
- Special banking packages launched for professionals, shareholders and employees of major companies that are customers.

Did you know?

The New Zealand merger of Trust Bank and Westpac to become WestpacTrust required 350km of cabling, 40,000 wardrobe items, 212 tonnes of starter stationery and 24,400 branch exchange days (97 working years).

In 1879 Ned Kelly stole £2,000 from the Jerilderie branch of the Bank of New South Wales a sum worth nearly $200,000 today. The money was never recovered.

The Rescue Helicopter has been swooping people from peril for 25 years now. Since 1973, the helicopter service has flown more than 30,000 missions in Australia and New Zealand.

Fabulous FABACUS, our first computer, was installed in 1965, taking up an entire floor of a city office building – today the same computing power fits into a filing cabinet!
33 years later, in 1998, Westpac launched its internet on-line banking, the next revolution in customer service and choice.

Business Banking provides a full range of financial services for small, medium and agri businesses, including day to day banking and cash management needs, finance risk management, trade finance, investments, employee benefits, information and advice, from a range of professional specialists.

- Over 370,000 business customers.
- In excess of $20 billion in finance committed to Australian businesses.
- Over 450 business bankers supported by extensive service teams.
- Specialist advisers in business finance, treasury risks, trade finance, financial planning, investments and superannuation, insurance, merchant services, and cash management solutions.
- 12,000 customers using PC banking services.
- Almost 90% of customers subscribe to telephone banking services and 50% are actively using this efficient service.
- 14,000 customers now using the revolutionary 'Business Options Overdraft' product launched in March 1998.
- A special banking package for farmers launched in conjunction with the National Farmers Federation.
- Active supporters of women in business forums and support activities.

Australian Guarantee Corporation (AGC) is one of Australasia's largest finance companies with over one million accounts and a market leader in its four core areas of activity.

- Dealer – wholesale finance to more than 300 motor dealers and also the provision of retail finance to buyers of new and used cars.
- Business Finance – equipment finance, vendor rental, insurance premium funding and current asset finance.
- Creditline – personal finance, mainly through third party introducers such as retail stores and specialist suppliers.
- Retail Funding – providing fixed rate/fixed term debentures, short-term deposits and money market access to about 160,000 personal investors.

Financial Services provides investment management, unit trusts, business and personal superannuation, general and life insurance, and custodian services.

- Over 480 financial consultants and planners operating through the branch network.
- Total retail product sales of $3.7 billion in the 1998 year.
- Over $19 billion in funds under management, an increase of 25% since September 1997.
- Ranked first for the year to June 1998 for net retail fund inflows with over $1.8 billion.
- The Westpac Personal Portfolio Service was the fastest growing discretionary master fund in the year to June 1998, with funds under administration now $2 billion.
- A measure of retail investment performance relative to competitors showed Westpac consistently among the top five major managers for the number of funds performing above the median of their peers.
- Assets under custody have increased to $98 billion, an increase of 12% since September 1997.
- For the second year in a row, Westpac was named the No.1 custodian in Australia by the USA-based *Global Custodian* magazine.
- The Westpac Property Trust completed three acquisitions during the year for a total of $228 million, maintaining its position as one of the three largest commercial trusts of its kind in Australia, with total assets in excess of $700 million.

Westpac and Microsoft have joined forces to develop diskless personal computers and the concept of the Standard Operating Environment – an idea which is now being marketed across the world. Pretty soon PCs will be as accessible and versatile as telephones.

33% of Westpac staff – that's 11,000 people – give up time to do volunteering work in the community. And about 6,500 of them volunteer on a regular basis.

The first branch opened in Moreton Bay (Brisbane) in November 1850, nine years before Queensland became a separate colony. Brisbane was then the major town in what were known as the 'middle districts' of New South Wales.

In 1979 the red 'W' became a familiar sight in Singapore as we established the first branch of an Australian bank in Asia.

Institutional Banking

	1998	1997
Profit on operations (million)	**$252**	$240
Total assets (billion)	**$44.6**	$38.6
Personnel numbers	**2,325**	2,431

Institutional Banking is relationship orientated and provides a full range of banking solutions to its target markets in Australia and New Zealand, enabling its customers to maximise their shareholders' wealth. It also provides banking solutions to overseas businesses and investors who have operations in Australia and New Zealand.

- Arranging, underwriting and sell down of debt and equities.
- Capital raising.
- Cash management.
- Corporate advisory.
- Financial markets services.
- Payment services.
- Property finance.
- Risk management and advisory services.
- Securitisation strategies and implementations.
- Structured finance transactions.
- Syndications and agency.
- Trade finance.

Institutional Banking's leadership is regularly recognised in independent surveys and awards including;

- No 1 Foreign Exchange Bank – *FX Week, Euromoney, Corporate Finance*,
- Australian Commercial Bank of the year – *Asiamoney*,
- No 1 in various aspects of dealing and trading in government securities and domestic debt issues – *FPRG Australia*.

Institutional Banking has offices throughout Australia and New Zealand and in the major financial centres of Tokyo, Hong Kong, Singapore, London and New York and is represented in Bangkok, Kuala Lumpur, Jakarta and Beijing.

WestpacTrust and Pacific Regional Banking

	1998	1997
Profit on operations (million)	**$284**	$285
Total assets (billion)	**$19.0**	$20.0
Personnel numbers	**7,711**	7,899

WestpacTrust provides a full array of consumer deposit, loan, card and transaction account products. It also provides a full range of transaction, electronic, deposit and lending products and financial services to sole proprietors, small and medium sized businesses.

- One of New Zealand's leading financial services organisations.
- 273 branches, 402 ATMs and nearly 19,000 EFTPOS terminals.
- Telephone banking (over 550,000 customers).
- 258,000 credit card and 118,000 debit card holders.
- WestpacTrust is the main bank to 27% of personal customers, 28% of sole proprietors, 25% of small businesses, 26% of middle size businesses, and the main transaction banker to 20% of large corporations, as well as the New Zealand Government.
- WestpacTrust Financial Services provides term investments, unit trusts, retirement plans and insurance.

Pacific Regional Banking provides a full range of deposit, loan, transaction account and international trade facilities to personal and business customers. In selected locations, finance company activities such as leasing, equipment finance and motor vehicle loans are also offered.

- Represented in 11 Pacific Island nations.
- 1,700 personnel.
- 89 branches and 5 ATMs.
- 841 EFTPOS merchants.
- 106,000 credit/ debit cards.

Westpac have been bankers to the Salvation Army since the 1890's – over 100 years of donations, in-kind support and the volunteer efforts of our staff.

In 1817, Westpac's first premises were leased from Mary Reibey, an ex-convict turned successful businesswoman. Her image is on the $20 banknote today.

50% of Westpac's Australian staff are also shareholders. That's about 12,000 people running it like they own it.

Westpac's Mortgage Processing Centre in Adelaide has the largest workplace child care creche in Australasia.

Easy access at the touch of a button

By internet

www.westpac.com.au

By phone

Australia	**Westpac**	**Bank of Melbourne**	**Challenge Bank**
Customer account enquiries and general information			
– personal customers	**13 2032**	**13 2575**	**13 1862**
– business customers	**13 2142**	**13 1919**	**13 2885**
Home loan enquiries	**13 1900**	**13 1575**	**13 1900**
Cardholder enquiries	**1300 651 089**	**1300 651 089**	**1800 061 547**
(including lost or stolen cards)			
ATM enquiries and service difficulties	**1800 022 022**	**1800 022 022**	**1800 022 022**
Financial Services	**13 1817**	**13 1817**	**13 1817**

New Zealand	**WestpacTrust**
Customer service	**0800 400 600**
Cardholder enquiries (including lost or stolen cards)	**0800 888 111**
Financial Services	**0800 738 641**

Did you know?

The two bronze lions dozing on the front steps of the 341 George Street, Sydney office are called Cleo and Leo. Which is which, we haven't checked!

Under our old moniker – the Bank of New South Wales – Westpac was the first Australian bank to introduce ATMs and the first bank in the world to establish a national EFTPOS system.

Since its introduction in 1994, the number of calls to our telephone service have increased 3,100% from 100,000 to 3.2 million per month.

Financial review

Five year summary

$m (unless otherwise indicated)	**1998**	1997	1996	1995	1994
Profit and loss – year ended 30 September[1]					
Net interest income (excluding gross up[2])	**3,492**	3,353	3,254	2,982	2,761
Fully taxable equivalent gross up[2]	**128**	127	68	45	61
Net interest income (including gross up[2])	**3,620**	3,480	3,322	3,027	2,822
Non-interest income	**2,003**	1,739	1,472	1,391	1,555
Operating income (including gross up)	**5,623**	5,219	4,794	4,418	4,377
Charge for bad and doubtful debts	**(168)**	(78)	(121)	(330)	(695)
Total operating income (including gross up) after charge for bad and doubtful debts	**5,455**	5,141	4,673	4,088	3,682
Non-interest expenses	**(3,392)**	(3,228)	(3,049)	(2,654)	(2,637)
Operating profit (including gross up) before income tax and abnormal items	**2,063**	1,913	1,624	1,434	1,045
Fully taxable equivalent gross up[2]	**(128)**	(127)	(68)	(45)	(61)
Income tax (expense)/credit	**(589)**	(493)	(421)	(371)	(276)
Outside equity interests	**(4)**	(2)	(3)	(3)	(3)
Operating profit after income tax before abnormal items	**1,342**	1,291	1,132	1,015	705
Abnormal items (net of tax)	**(70)**	–	–	(68)	–
Operating profit after income tax attributable to shareholders	**1,272**	1,291	1,132	947	705
Balance sheet at 30 September[1]					
Total assets	**137,319**	118,963	121,513	105,835	93,861
Loans	**91,738**	77,874	81,201	64,365	61,242
Acceptances	**10,325**	11,242	11,197	11,656	12,219
Deposits and public borrowings	**83,164**	72,636	74,886	58,198	54,925
Loan capital	**2,523**	1,895	2,199	2,881	2,929
Shareholders’ equity (including outside equity interest)	**8,611**	8,206	7,891	7,583	7,299
Total risk adjusted assets	**97,430**	99,840	86,503	74,930	72,567
Share information					
Earnings per share (cents)					
Before abnormals	**70.1**	70.0	58.9	53.5	36.0
After abnormals	**66.4**	70.0	58.9	49.8	36.0
Dividends per ordinary share (cents)	**43.0**	39.0	33.0	28.0	18.0
Net tangible assets per ordinary share ($)[3]	**3.59**	3.69	3.39	3.81	3.67
Share price ($)					
High	**11.45**	9.10	6.59	5.51	5.55
Low	**7.10**	6.43	5.20	3.90	3.83
Close	**9.28**	8.70	6.54	5.36	4.20
Ratios					
Shareholders' equity to total assets (%)	**6.3**	6.9	6.5	7.2	7.8
Risk adjusted capital ratio (%)	**9.4**	10.5	10.8	13.9	13.8
Dividend payout ratio (%)	**64.6**	55.3	55.3	56.3	50.3
Return on:					
Ordinary shareholders' equity – average (%)	**14.7**	17.0	14.6	13.0	9.8
Total assets – average (%)	**0.91**	1.03	0.97	0.97	0.71
Productivity ratio[4]	**3.30**	2.97	2.77	n/a	n/a
Expense to income ratio (%)[5]	**60.3**	61.9	63.6	59.8	58.7
Net interest margin	**3.4**	3.6	3.7	3.8	3.5
Other information					
Points of bank representation (number at period end)	**1,832**	1,547	1,788	1,547	1,616
Full time equivalent staff (number at period end)[6]	**33,222**	31,608	33,832	31,416	31,396

Notes

1 The above profit and loss extracts for 1998, 1997 and 1996 and balance sheet extracts for 1998 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 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. The income tax rate was 36% for 1998, 1997 and 1996, and 33% for 1995 and 1994.

3 After deducting preference share capital and intangible assets.

4 Operating income (including gross up)/personnel costs excluding restructuring expenses.

5 Excludes superannuation adjustment.

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

Overview of performance

Summary consolidated profit and loss statements for the years ended 30 September

	1998 $m	1997 $m	1996 $m
Net interest income (excluding gross up)	**3,492**	3,353	3,254
Fully taxable equivalent gross up[1]	**128**	127	68
Net interest income (including gross up)	**3,620**	3,480	3,322
Non-interest income	**2,003**	1,739	1,472
Operating income (including gross up)	**5,623**	5,219	4,794
Charge for bad and doubtful debts	**(168)**	(78)	(121)
	5,455	5,141	4,673
Non-interest expenses	**(3,392)**	(3,228)	(3,049)
	2,063	1,913	1,624
Fully taxable equivalent gross up[1]	**(128)**	(127)	(68)
Income tax expense	**(589)**	(493)	(421)
Outside equity interests	**(4)**	(2)	(3)
Operating profit (excluding gross up) after income tax before abnormals	**1,342**	1,291	1,132
Abnormal items net of income tax	**(70)**	–	–
Operating profit after tax attributable to shareholders	**1,272**	1,291	1,132
Earnings per share (cents)			
Basic before abnormals	**70.1**	70.0	58.9
Basic after abnormals	**66.4**	70.0	58.9
Fully diluted before abnormals	**68.0**	67.8	57.1
Fully diluted after abnormals	**64.5**	67.8	57.1

1 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.

The 1998 profit result represents continued steady progress on Westpac's primary objective of building long term shareholder value. It reflects the benefits of Westpac's focus on earnings quality through the full credit cycle, built on the foundations of solid risk management and a sound capital position.

Operating profit after income tax (before abnormal items) was $1,342 million, a 4% increase on the previous year. After abnormal items, 1998 operating profit after tax was $1,272 million. Core earnings[1] increased 13.8% to $2,337 million.

This result was achieved in the context of intense competition in the Australian and New Zealand markets, increased charge for bad and doubtful debts to maintain coverage ratios at this stage of the credit cycle, and a higher average tax rate.

Earnings per share (EPS) before abnormals was stable at 70.1 cents, despite an average 5.0% increase in shares on issue due to the merger with Bank of Melbourne and the conversion of preference shares. Before intangibles and abnormals EPS increased 3.1% to 75.8 cents.

The return on capital employed, adjusted for the accounting impacts of goodwill, continued to improve with the pre-abnormal tangible return on tangible equity increasing from 20.9% to 21.5% during the year.

The abnormal item of $70 million after tax principally relates to expenditure of a non-capital nature, as part of the recently announced upgrading of the national retail branch network. The planned modernisation of the network will make branches more accessible and convenient for customers. This progressive approach to improving service delivery will involve the introduction of new sales and service outlets and the modernisation and reshaping of the existing network.

1 Operating profit (including gross up) before charge for bad and doubtful debts, income tax, intangibles and abnormals.

Profit and loss review

The 1998 profit result reflects Westpac's strategy to focus on the markets it knows well in Australasia, and on earnings quality built around skilled staff, pricing for risk, prudent provisioning and a strong balance sheet and capital structure, with the aim of delivering sustainable earnings throughout the credit cycle.

Net interest income

Net interest income increased by $140 million, or 4.0% to $3,620 million in 1998, and by $158 million, or 4.8% to $3,480 million in 1997.

Interest spread and margin

	1998 $m	1997 $m	1996 $m
Adjusted net interest income (including gross up[4])	**3,620**	3,480	3,322
Average interest earning assets	**105,338**	96,827	89,332
Average non-accrual loans	**830**	852	1,584
Average interest bearing liabilities	**94,633**	85,415	77,504
Average net non-interest bearing liabilities	**10,705**	11,412	11,828
Group			
Interest spread on productive assets[2]	**2.90%**	2.90%	2.92%
Impact of impaired loans	**(0.04)%**	(0.03)%	(0.10)%
Interest spread[1]	**2.86%**	2.87%	2.80%
Benefit of net non-interest bearing liabilities and equity[3]	**0.58%**	0.72%	0.90%
Interest margin	**3.44**%	3.59%	3.72%
On a geographical basis, interest spread and margins were:			
Australia			
Interest spread on productive assets[2]	**3.16%**	3.26%	3.34%
Impact of impaired loans	**(0.04)%**	(0.04)%	(0.10)%
Interest spread[1]	**3.12%**	3.22%	3.24%
Benefit of net non-interest bearing liabilities and equity[3]	**0.54%**	0.72%	0.89%
Interest margin	**3.66%**	3.94%	4.13%
New Zealand			
Interest spread on productive assets[2]	**2.74%**	2.80%	2.88%
Impact of impaired loans	**(0.03)%**	(0.02)%	(0.07)%
Interest spread[1]	**2.71%**	2.78%	2.81%
Benefit of net non-interest bearing liabilities and equity[3]	**0.11%**	0.19%	0.49%
Interest margin	**2.82%**	2.97%	3.30%
Overseas			
Interest spread on productive assets[2]	**0.74%**	0.63%	0.36%
Impact of impaired loans	**(0.04)%**	(0.02)%	(0.02)%
Interest spread[1]	**0.70%**	0.61%	0.34%
Benefit of net non-interest bearing liabilities and equity[3]	**0.83%**	0.88%	0.86%
Interest margin	**1.53%**	1.49%	1.20%

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 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, New Zealand and overseas 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 the year, interest spreads were maintained, reflecting the benefits of net interest income hedging and the full year benefit of the Group's securitisation of assets in 1997 and additional securitisation of $3.7 billion in 1998 (as securitisation removes lower margin assets from the balance sheet). In addition, offshore funding has been accessed at a lower cost during the year. These spread enhancing strategies have predominantly offset the full year impact of interest rate cuts in Australia during 1997, and margin compression resulting from competitive pressures in Australia and New Zealand.

In 1998, interest margin for the Group declined 15 basis points to 3.44% with the benefit of net non-interest bearing liabilities and equity falling from 0.72% to 0.58%. The reduction in the benefit of net non-interest bearing liabilities and equity reflects the full year impact of rate cuts in Australia in 1997, and the impact of the continued buy-back of share capital, which reduces the level of free funds. This has been partially offset by the benefit arising on the acquisition of Bank of Melbourne, which was predominantly funded by the issue of shares.

Australia The interest spread in Australia declined 10 basis points to 3.12% in the year ended 30 September 1998. The spread was impacted by the merger with Bank of Melbourne, which had a lower interest spread, principally due to the mix of assets in its portfolio, with a relatively higher proportion of housing loans. Excluding the impact of Bank of Melbourne, Australian interest spreads have decreased by 2 basis points to 3.20%.

With the benefit of net non-interest bearing liabilities and equity declining from 0.72% to 0.54% in 1998, the interest margin in Australia has declined to 3.66%.

New Zealand Interest spread in New Zealand fell by 7 basis points from 2.78% in 1997 to 2.71% in 1998, principally reflecting a reduction of 6 basis points in the rate earned on productive assets.

The rate earned on loans and other receivables for 1998 remained constant at 10.4%. The cost of deposits rose from 7.1% in 1997 to 7.3% in the same period, however the diversity of funding utilised enabled this adverse impact to be offset.

The benefit of net non-interest bearing liabilities and equity decreased by 8 basis points from 0.19% to 0.11%, leading to a decline in interest margin of 15 basis points to 2.82%.

Non-interest income analysis

The components of non-interest income are detailed in note 3 to the financial statements. Non-interest income in 1998 was $2,003 million, an increase of $264 million over the 1997 level of $1,739 million, which was $267 million over the 1996 level of $1,472 million.

Non-interest income increased by $264 million or 15.2%, resulting from the provision of a more comprehensive range of products to customers and the development of new non-interest earning streams, such as mortgage servicing. Non-interest income now accounts for 35.6% of total operating income, up from 33.3%.

Lending fees increased by $69 million or 15.7% reflecting increased lending volumes, especially in housing products. Transaction fees and commissions received increased $50 million or 10.4%, due principally to the introduction of additional product features and an increase in card merchant business and associated fee income, in particular through the success of the Global Rewards Visa card.

Other non-risk fees increased by $63 million or 23.2% due principally to volume growth, the introduction of new products and services, and the full period impact of the retained spread over the investor margin on the growing portfolio of securitised assets. In addition, management and services fee income have increased as a result of the strong growth in funds under management.

Retail financial services product sales and funds under management continued to grow strongly with total funds under management increasing during the year from $15.5 billion to $19.3 billion at 30 September 1998, an increase of 24.5%. Insurance commissions and premiums growth of $12 million or 37.5% resulted from the broadening of the product range and increased sales to the extensive Westpac customer base. Overall, this focus on retail financial services reflects Westpac's capacity to provide a wide choice of products and services for customers.

Volatility created by the Asian economic environment resulted in strong sales and trading activity, particularly in risk management products. Total financial markets income is up by $106 million reflecting this increased level of activity. The composition of the financial markets income has changed on the prior year with net interest income down by $66 million and non-interest income up by $172 million.

The decline in other income principally reflects a reduction in the net profit on sales of premises and investments. The $34 million profit in 1998 reflects Westpac's continuing rationalisation of its CBD property portfolio and branch sale and leaseback program. Lease rental income has reduced in line with the sale of properties.

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 and external underlying factors. As the portfolio size, composition, inherent risk and loan loss experience change, the level of total provisions is adjusted. The resulting level of total provisions should be sufficient to cover loan losses inherent in the current loan portfolios.

The total charge against profits for bad and doubtful debts in 1998 was $168 million, an increase of 115% from the 1997 charge of $78 million, which, in turn, was a decrease of 36% from the 1996 charge of $121 million.

Ongoing portfolio reviews during the second half of 1998 resulted in a decision to increase provisioning cover against Asian exposure by a net $30 million to $160 million, to protect against further possible negative developments. This is largely the result of a deterioration in the global economic outlook. Provisions held against Asian exposures now total $101 million of specific provisions, with a further $59 million of general provisions. Continued reductions in impaired assets in the non-Asian portfolio have partially offset the impact of increased provisioning for Asia. Total provisions to total impaired loans remain at prudent levels of 187.9% at 30 September 1998 (184.2% at 30 September 1997 and 145.1% at 30 September 1996).

In determining the general provision level for September 1998, $20 million has been allocated to cover risks arising from potential customer defaults in meeting credit obligations because of inadequate preparation for Year 2000 problems. Westpac will continue to re-assess the adequacy of this provision allocation as the millennium draws nearer.

Bad and doubtful debt charge

	1998 $m	1997 $m	1996 $m
New specific provisions	**225**	146	200
Specific provisions no longer required	**(141)**	(213)	(463)
Specific provisions (net)	**84**	(67)	(263)
General provisions (net)[1]	**84**	145	384
	168	78	121

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 1998 were $3,392 million, an increase of $164 million over the 1997 level of $3,228 million, which was $179 million over the 1996 level of $3,049 million.

Excluding the impact of Bank of Melbourne, non-interest expenses declined $86 million or 2.7% reflecting a continuing emphasis on expense control and the realisation of benefits arising from Westpac's continued focus on improving operational efficiency.

The expense to income ratio before intangibles improved from 60.7% to 58.4% with the productivity ratio increasing from 2.97 to 3.30. This reflects the impact of merger synergies, the benefits arising from the centralisation of back-office functions and growth in operating income.

Operating lease rentals increased by $57 million to $279 million reflecting an increase in lease rentals in Australia, as a result of the branch sale and leaseback program, and the impact of Bank of Melbourne, partially offset by synergy benefits from mergers.

The depreciation charge for leasehold improvements increased $15 million in line with the increase in the number of operating leases following the sale and leaseback program. The increase in technology depreciation of $18 million is in line with Westpac's ongoing investment in infrastructure to improve operational efficiency.

The increase in the amortisation of intangibles reflects the impact of Bank of Melbourne.

Consulting fees, computer software maintenance and other professional services increased $24 million reflecting the integration of Bank of Melbourne, Year 2000 project costs and ongoing focus on initiatives to substantially improve productivity.

The increase in stationery, postage and telecommunication costs principally reflects merger related activity for both Bank of Melbourne and WestpacTrust.

The increase in advertising of $25 million reflects Sydney 2000 Olympic Games related home loan campaigns, the impact of Bank of Melbourne, and merger related advertising in New Zealand.

Income tax expense

	1998 $m	1997 $m	1996 $m
Excluding abnormal items			
Income tax expense	**589**	493	421
Fully taxable equivalent gross up	**128**	127	68
	717	620	489
Tax as a percentage of operating profit before tax and abnormal items (effective tax rate)	**34.8%**	32.4%	30.1%
Including abnormal items			
Income tax expense	**553**	493	421
Fully taxable equivalent gross up	**128**	127	68
	681	620	489
Tax as a percentage of operating profit (including abnormal items) before tax (effective tax rate)	**34.8%**	32.4%	30.1%

Westpac's effective tax rate, before abnormals, was 34.8% in 1998. This was below the Australian company tax rate of 36% due principally to the impact of lower overseas tax rates and certain non-taxable capital profits.

Balance sheet review

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

Westpac's balance sheet movements reflect a disciplined approach to asset pricing to ensure appropriate returns on capital and rewards for risk.

	(Decrease)/Increase 1998 $bn	1997 $bn
Assets		
Due from other financial institutions	**(0.7)**	(2.3)
Trading securities	**0.6**	0.6
Loans	**13.9**	(3.3)
Acceptance of customers	**(0.9)**	–
All other assets (net)	**5.5**	2.4
Net increase/(decrease)	**18.4**	(2.6)
Liabilities and shareholders' equity		
Due to other banks	**(0.2)**	(0.8)
Deposits and public borrowings	**10.5**	(2.2)
Acceptances	**(0.9)**	–
All other liabilities (net)	**8.6**	0.1
Shareholders' equity	**0.4**	0.3
Net increase/(decrease)	**18.4**	(2.6)

Assets Total assets increased by $18.4 billion or 15.4% to $137.3 billion at 30 September 1998. This increase excludes additional net securitised assets of $2.4 billion for the year. The growth includes assets acquired through the merger with Bank of Melbourne which contributed $11.5 billion or 8.4% to total assets.

Loans increased by $13.9 billion with the provision for doubtful debts remaining stable at $1.6 billion. In Australia, loans increased by $14.5 billion including Bank of Melbourne loans of $10.6 billion. This principally comprises an increase in housing loans of $9.1 billion and $2.1 billion in non-housing loans. Continued focus on marketing of credit card products, together with the continued success of the Global Rewards Visa card, has resulted in a 22% growth ($0.5 billion) in outstandings in Australia. Adjusting for the impact of $3.5 billion of securitisation during the year, total adjusted Australian loans increased by $18.0 billion.

In New Zealand, the impact of exchange rate fluctuations has reduced total assets by approximately $1.0 billion. Adjusting for the impact of exchange rate fluctuations and the securitisation of NZ$298 million of housing loans, gross loans increased by 2%.

The increase in other assets of $5.5 billion principally reflects the increase in other financial market assets, from the revaluation impact of off-balance sheet instruments due to the depreciation of the AUD against the USD and the decline in interest rates.

Liabilities Liabilities increased by $17.9 billion or 16.2% at 30 September 1998, with $7.6 billion resulting from the merger with Bank of Melbourne.

The growth in deposits and public borrowings reflects the growth in the lending portfolio and the impact of Bank of Melbourne.

All other liabilities increased by $8.6 billion. This principally represents an increase in the wholesale funding requirements of approximately $4.3 billion, as reflected in the increase in bonds, notes and commercial paper, and an increase in other liabilities from the revaluation impact of off-balance sheet instruments (due to the depreciation of the AUD against the USD and the decline in interest rates).

Shareholders' equity Shareholders' equity has increased by $0.4 billion, mainly due to the issue of shares for the Bank of Melbourne merger, partially offset by share buy-backs.

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 1998, shareholders' equity stood at $8.6 billion, up $0.4 billion from year end 1997. This increase is due to the issue of 142 million shares as part consideration for the merger with Bank of Melbourne and 1998 earnings of $1,272 million, less dividends of $830 million. This increase was partially offset by the buy-back of 132 million shares which reduced equity by $1.3 billion.

The maintenance of a strong capital position is reflected with a tier 1 capital ratio of 6.8% and total tangible equity to tangible asset ratio of 5.0% at 30 September 1998.

On 8 May 1998, reflecting Westpac's strong capital position and its active management of capital, the Board announced an on market buy-back of up to 60 million ordinary shares (approximately 3%) over a period of 6 months, the fifth such program that Westpac has undertaken. The programs have resulted in the repurchase and cancellation of 262 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 22 cents per share, taking the full year dividend on ordinary shares to 43 cents per share (fully franked) up from 39 cents per share (fully franked) in 1997.

Capital ratios

	1998	1997
Tier 1	**6.8%**	8.0%
Tier 2	**3.2%**	3.1%
APRA Statutory deductions	**(0.6)%**	(0.6)%
Capital ratio	**9.4%**	10.5%

Global funding

Westpac's wholesale markets funding strategy is based on diversity and flexibility. This is underpinned by the objectives of reducing the volatility and cost of its wholesale funding base within the parameters of prudent liquidity management.

International diversification is a cornerstone in establishing on-demand access to wholesale funding markets, readily accommodating the bank's demand for funds and providing an ability, under adverse market changes, to access one or more of those markets. Diversification is viewed from a number of angles including maturity term, type (retail, wholesale or asset backed), geography, currency and funding instrument.

Westpac actively markets itself to debt investors through international debt credit roadshows, the Westpac Website, the Bloomberg Financial Markets Information System and an annual Global Funding Debt Investor Brochure. These marketing tools all serve to promote and differentiate Westpac from other bank and corporate entities in the international capital markets, and are a key part of the bank's strategy in reaching and forging relationships, on a global basis, with new and existing debt investors.

Publicly syndicated transactions launched during 1997/98 financial year

Launch Date	Type	Market	Maturity	
October 1997	USD 500 million fixed rate bond	Euro market	October 2002	(5 years)
December 1997	USD 300 million floating rate note	Euro market	January 2003	(5 years)
March 1998	USD 50 million fixed rate Uridashi bond	Japanese domestic retail market	March 2001	(3 years)
March 1998	CHF 200 million fixed rate bond	Swiss domestic market	April 2003	(5 years)
April 1998	AUD 300 million floating rate note	Euro market	May 2003	(5 years)
April 1998	JPY 15 billion dual currency Uridashi bond	Japanese domestic retail market	May 2001	(3 years)
March 1998	AUD 300 million subordinated debt	Australian domestic market	May 2008	(10 years)
June 1998	GBP 250 million floating rate note	Euro market	June 2003	(5 years)
July 1998	USD 500 million floating rate note	Euro market	July 2001	(3 years)

Over the last 2 years Westpac's debt issues have been predominantly focused on international institutional investors, particularly the Euro floating rate markets. During 1997/98, Westpac launched funding transactions primarily targeted at retail investors in Japan and Switzerland. The two Japanese retail investor transactions put Westpac in the position of being the first non-government Australian issuer to tap this market.

The USD 500 million issue launched in October 1997 was Westpac's inaugural fixed rate transaction in the Euro markets and was voted, by respected intermediaries in the international capital markets publication Euroweek, as the fourth best transaction by a financial institution in 1997 out of approximately 1300 transactions completed that year.

In terms of overall performance, intermediaries in the international capital markets voted Westpac, first out of 340 other financial institutions who accessed the Euromarkets during the year, and named Westpac as 'Outstanding Financial Institution Borrower 1997' in *Euroweek.*

Westpac debt programs

Access to diverse international debt markets and investors is provided by the following programs and issuing shelves:

Program / Issuing Shelf	Market
USD 5 billion Euro Medium Term Note Program	Euro market
USD 2 billion Euro Commercial Paper Program	Euro market
USD 2 billion Euro Certificate of Deposit Program	Euro market
AUD 2 billion Asian Debt Program	Asia
Australian Domestic Medium Term Note Program	Australia
NZD 750 million New Zealand Domestic Medium Term Note Program	New Zealand
USD 3 billion US Medium Term Deposit Note Program	United States of America
USD 3 billion US Commercial Paper Program	United States of America
JPY 100 billion Uridashi Shelf	Japan
JPY 100 billion Samurai Shelf	Japan

Business group results

To enable a more in-depth 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 add 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 the sale of equity investments. Where the management reporting structure has changed or where accounting re-classifications have been made, comparatives have been restated and will therefore differ from results previously reported.

Business results – Australian Retail Banking and Financial Services

	1998 $m	1997 $m	Movement %
Net interest income	**2,574**	2,375	8.4
Non-interest income	**944**	729	29.5
Operating income	**3,518**	3,104	13.3
Charge for bad and doubtful debts	**(143)**	(159)	(10.1)
Operating income net of provisions for bad and doubtful debts	**3,375**	2,945	14.6
Non-interest expenses	**(2,235)**	(1,990)	12.3
Operating profit before tax	**1,140**	955	19.4
Tax and outside equity interests	**(390)**	(329)	18.5
Profit on operations	**750**	626	19.8
	$bn	$bn	%
Deposits and other public borrowings	**41.9**	34.8	20.4
Net loans and acceptances	**62.7**	50.2	24.9
Total assets	**68.9**	55.7	23.7
Funds under management	**19.3**	15.5	24.5
Expense/income (before intangibles)	**61.8%**	63.6%	
Productivity ratio	**3.05**	2.74	
Non-interest income/operating income	**26.8%**	23.5%	

Australian Retail Financial Services represents the combined results of Westpac's Regional Banks, Australian Guarantee Corporation (AGC) and Westpac Financial Services.

In 1998, profit on operations increased by approximately 20%, reflecting growth in the portfolio via increased product penetration and cross selling to a larger customer base.

Growth has been achieved by utilising an integrated sales approach leveraging off the customer base of both the existing Westpac network and new customers gained through Westpac Life, Challenge Bank and Bank of Melbourne. Product cross selling continues to deliver strong growth in sales of financial services and consumer finance products. The continued focus on reducing the cost base via investment in infrastructure, increased skilling of staff and other projects focused on improving productivity, has directly benefited customers via a portfolio of competitively priced products.

Whilst Bank of Melbourne has contributed incremental net interest income, strong competition and record low interest rates have seen continuing pressure placed on net interest income. This has been particularly evident in business lending, deposit products, personal loans and some transaction accounts. Additionally, the full period impact of securitisation completed in prior years, together with additional securitisation during 1998, reduced net interest income (but increased non-interest income).

Non-interest income increased $215 million or 29.5%. The major contributors to this increase being fee income earned by Bank of Melbourne, growth in fees from retail funds under management and increased general and life insurance income. Credit card merchant business and associated fee income, particularly the highly successful Global Rewards Visa product and the additional opportunities that flow from the sponsorship of the Sydney 2000 Olympic Games, have also contributed to the growth.

Non-interest expenses were flat on the prior year, excluding the $250 million related to Bank of Melbourne.

The lower charge for bad and doubtful debts reflects a reduction in impaired assets, lower levels of new specific provisions and higher recoveries of debts written off in previous periods.

Business results – Institutional Banking

	1998 $m	1997 $m	Movement %
Net interest income	**417**	445	(6.3)
Non-interest income	**541**	405	33.6
Operating income	**958**	850	12.7
Charge for bad and doubtful debts	**(84)**	18	566.7
Operating income net of provisions for bad and doubtful debts	**874**	868	0.7
Non-interest expenses	**(463)**	(495)	(6.5)
Operating profit before tax	**411**	373	10.2
Tax and outside equity interests	**(159)**	(134)	18.7
Profit on operations	**252**	240	5.0
	$bn	$bn	%
Deposits and other public borrowings	**18.6**	13.7	35.8
Net loans and acceptances	**20.7**	20.1	3.0
Total assets	**44.6**	38.6	15.5
Expense/income (before intangibles)	**48.3%**	58.3%	
Productivity ratio	**4.01**	3.48	
Non-interest income/operating income	**56.5%**	47.6%	

Institutional Banking provides commercial and investment banking products and services to corporate and institutional customers either based, or with significant operations, in Australia and New Zealand in the areas of financing, financial markets, transactional services (cash management, trade and payment products) and corporate finance.

Institutional Banking's goal is to be the pre-eminent wholesale bank in Australasia. Its core strategy of customer intimacy aims to deliver innovative and tailored products, solutions and service to a clearly defined market, and it continues to be a market leader in the relationship management of its core customers.

The general downturn in the global economy, the increased globalisation of financial services, and the rising commitment of global investment banks to Australasia, has increased competition in all business units within Institutional Banking. As a result, 1998 has seen a significant compression in margins, a commoditisation of core product sets, and a significant increase in volatility in credit exposures, revenues and returns across all business units.

Despite this backdrop, operating profit before tax increased by $38 million or 10.2% over 1997. Declining market conditions in Asia however, have resulted in the bad debt charge increasing by $102 million. Core earnings increased by $140 million on the prior year.

Total expenses have fallen by $32 million or 6.5%, inclusive of costs related to the completion of the Real Time Gross Settlement system and the global centralisation project during the year. Significant system expenditure was also incurred to ensure Year 2000 capability. These projects will provide the opportunity for further cost savings in future years and ensure that the requirements of customers continue to be met. The expense to income ratio improved to 48.3%.

The majority of the growth in operating income was generated in financial markets, with operating income increasing by $98 million over the prior year. Volatility in the world's financial markets has continued through the second half of the year and resulted in strong sales and trading activity, particularly in risk management products. The composition of the financial markets income has changed on the prior year with net interest income down by $33 million and non-interest income up by $131 million.

Corporate Finance had a solid year with the second half performance benefiting from the sale of infrastructure bonds and an increase in the advisory activities provided to customers.

Competitive pressures and historically low interest rates contributed to contracting margins and reductions in net interest income in the traditional lending products. Transactional businesses have also experienced contracting margins but these have been offset through growth in business volumes and deposit levels.

The Property Finance business performance has been sustained, while the overall quality of the portfolio has improved over the year, reflecting the focus on maintaining the level of risk adjusted returns.

The bad debt charge of $84 million compares to net write backs of $18 million recorded in the prior year. The impact of the Asian economic conditions has resulted in increases in doubtful debt provisions through the dynamic provisioning process. Notwithstanding the adverse impact of the Asian economic environment, the loan book remains well provisioned.

Asset levels have increased from $38.6 billion to $44.6 billion. This is predominantly due to revaluations of forward contracts arising from the fall in the spot value of the A$ against the US$ in the current year. Balance sheet management remains an area of focus and Westpac continues to be selective in providing lower margin corporate lending to customer relationships that provide an adequate overall return on shareholders funds.

Business results – New Zealand and Pacific Regional Banking

	1998 $m	1997 $m	Movt %
Net interest income	**789**	791	(0.3)
Non-interest income	**338**	331	2.1
Operating income	**1,127**	1,122	0.4
Charge for bad and doubtful debts	**(10)**	(30)	(66.7)
Operating income net of provisions for bad and doubtful debts	**1,117**	1,092	2.3
Non-interest expenses	**(691)**	(667)	3.6
Operating profit before tax	**426**	425	0.2
Tax and outside equity interests	**(142)**	(140)	1.4
Profit on operations	**284**	285	(0.4)
	$bn	$bn	%
Deposits and other public borrowings	**14.0**	14.1	(0.7)
Net loans and acceptances	**17.1**	18.0	(5.0)
Total assets	**19.0**	20.0	(5.0)
Funds under management	**0.9**	1.1	(18.2)
Expense/income (before intangibles)	**58.0%**	56.0%	
Productivity ratio	**3.71**	3.41	
Non-interest income/operating income	**30.0%**	29.5%	

WestpacTrust and Pacific Regional Banking provide retail financial services in New Zealand and the Pacific respectively.

WestpacTrust

Profit on operations decreased $21 million in the year. After adjusting for the impact of exchange rate fluctuations, profit on operations decreased by $15 million, reflecting a one-off increase in non-interest expenses over the prior year due to integration costs resulting from the merger.

Net interest income increased by $10 million (adjusted for exchange rate variances) over the prior year with increased loan volumes partially offset by lower margins. WestpacTrust also securitised NZ$298 million in housing loans during the year, the first transaction of this type for the New Zealand operation.

Non-interest income increased by $3 million (adjusted for exchange rate variances) on the prior year in line with the growth in lending and the extension of financial services products to the broader WestpacTrust customer base.

The bad and doubtful debts charge increased over the prior year. The 1997 result benefited from a higher level of recoveries than experienced in the current year.

Pacific Regional Banking

During 1998 all markets within the Pacific region were impacted by the global economic downturn, and there have been considerable economic challenges confronting the regional governments over the past few years, resulting in subdued economic growth. Despite this, Pacific Regional Banking recorded a 51% improvement in overall profit on operations in the current year due to growth in operating income and further bad debt recoveries. This excellent performance was achieved against a background of flat economic growth and market volatility, following substantial currency movements in the Fiji dollar and PNG kina.

Net interest income grew by $6 million or 6% due to a combination of increased lending across most locations and maintenance of margins through active balance sheet management. Weak economic activity throughout the region continues to dampen growth opportunities. Overall balance sheet totals have been adversely impacted in Australian dollar terms by the 20% devaluation of the Fiji dollar in January 1998 and the substantial depreciation of the PNG and Solomon Islands currencies during the year.

Non-interest income has increased by $11 million or 18.5% on the prior year. This improvement was enhanced through growth in foreign exchange income in PNG, Fiji and Solomon Islands due to greater turnover and market volatility.

Expenses have been held flat in local currency terms with the expense to income ratio improving from 65.7% to 60.2%.

Significant improvements have been made in overall portfolio quality with low levels of new specific provisions required and strong recoveries of bad and doubtful debts. The strategy has continued to focus on establishing a risk profile in selected market segments, consistent with the emerging economic cycle.

Derivative activities

Derivative contracts include forwards, futures, swaps and options, all of which are bilateral contracts or payment exchange agreements, whose values derive 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 by 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 30 to the financial statements.

Derivatives are flexible and cost-effective tools for assisting in the management of interest rate, exchange rate, commodity, equity and credit exposures, and for structuring finance and investment strategies. Derivatives can provide 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 as part of its asset and liability management activities. Derivatives positions used in Westpac's asset and liability management activities are transacted internally with the Group's independently managed dealing units. The dealing units, in turn, cover their positions externally in the marketplace. Any such external transactions are reflected in the dealing activities information below.

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 for 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 replacement cost, and the regulatory credit equivalent (for details refer to note 30 of the financial statements).

Total notional amounts outstanding is a measure of volume, which may be used for examining changes in derivatives activities over time. The notional amount is the face value of the contract. 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 1998, the notional amount outstanding was $533.8 billion ($486.9 billion at 30 September 1997).

Replacement cost/positive mark-to-market is the cost of replacing all transactions in a gain position to Westpac. Conversely, negative mark-to-market represents the cost to Westpac's counterparties of replacing all transactions in a loss position to Westpac. 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 1998, total positive mark-to-market (gross replacement cost) was $12.4 billion and negative mark-to-market was $11.6 billion ($8.7 billion and $8.9 billion, respectively, at 30 September 1997). Average values for the 1998 year, based on an average of spot end-of-month balances were $12.7 billion and $12.0 billion, respectively, ($7.4 billion and $8.2 billion for the year to 30 September 1997).

Regulatory credit equivalent is calculated for capital adequacy purposes using the Australian Prudential Regulation Authority (APRA) current exposure method. Credit equivalent amounts are calculated as replacement cost (positive mark-to-market) plus an add-on for potential future credit exposure based on a credit conversion factor (percentage) of the notional amount. The credit conversion factors are as shown below:

Current exposure method – credit conversion factors

	Less than 1 year %	Over 1 year to 5 years %	Over 5 years %
Interest rate	–	0.5	1.5
Foreign exchange (including gold)	1.0	5.0	7.5
Equities	6.0	8.0	10.0
Precious metals (excluding gold)	7.0	7.0	8.0
Other commodities	10.0	12.0	15.0

At 30 September 1998, regulatory credit equivalent was $18.4 billion ($13.9 billion at 30 September 1997).

The increase in notional amounts outstanding, positive and negative mark-to-market and regulatory credit equivalent has been driven by increased market volatility and the translation impact of the significant fall in the Australian dollar during 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 promote leveraged derivative transactions.

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	**1998 $m**	1997 $m	1996 $m
By accounting line			
Foreign exchange income	**295**	182	175
Trading securities income	**34**	26	20
Other financial markets income	**81**	30	23
Net interest income	**47**	113	129
Total	**457**	351	347
By business activity			
Foreign exchange (spot and options)	**214**	149	142
Interest rate contracts and other[1]	**243**	202	205
Total	**457**	351	347

1 Interest rate and currency swaps, options, foreign exchange forwards, forward rate agreements, financial futures, debt securities, and commodity and equity derivatives.

Risk management within Westpac

Risk is the potential for damage or loss associated with the business activities that Westpac undertakes. Taking and managing risk is a central part of Westpac's business. For management purposes three types of risk are recognised:

- **Credit Risk** is the risk of financial loss from the failure of a customer to honour fully the terms of its contract with Westpac;
- **Market Risk** is the risk to earnings from changes in market factors such as interest and foreign exchange rates, or in the liquidity profile; and
- **Operational Risk** is the risk of unexpected financial, reputational or other damage arising from the way the organisation pursues its business objectives.

Risk management framework

To monitor risk, Westpac uses a consistent management framework. This is a dynamic approach in which the Board and executive link the active management of risk with the pursuit of agreed business strategies and objectives. It has five elements:

- Strategic intent – The organisation has a clear vision, a uniting set of values and a firm purpose. This is based on a shared understanding between the Board and senior management on the critical areas of business and portfolio strategy, the trade offs between commercial return and prudent risk-taking, and the limits and boundaries beyond which risk is deemed unacceptable at any price. Supporting the strategic intent is a clearly defined organisational structure, within which executive roles and responsibilities are fully understood and accepted.
- Business objectives – Strategic intent translates into business objectives and activities. Within each organisational unit, there are clear, realistic budgets and objectives, of which accountable managers take full ownership. The objectives are framed to optimise returns on shareholder capital, calculated and adjusted to reflect the risk profile of the business. It is then the responsibility of management to monitor, in a disciplined manner, the risk adjusted performance of the business against these objectives.
- Risk assessment – This element balances the business objectives with Westpac's understanding of business risk and a deliberate risk appetite. A firm-wide approach is adopted to identify all business risks – credit, market and operational. Decisions are made whether to remove, reduce, transfer or accept the risks.
- Risk response – This is the core of integrated risk management. It relies on sound policies and practices, and sensitive pre-set tolerances and risk limits. Robust systems measure actual risk against key indicators. Experienced people monitor these, and are supported by short, clear communication channels. When tolerances are tested, swift remedial measures protect the bank.
- Continuous assessment and review – The dynamic nature of risk requires continuous review and assessment of the risk profile to reflect changes in the level and intensity. This is the feedback loop which marks a genuine commitment to effective risk management. In the face of changing external forces and risks, Westpac dynamically adjusts the strategies, objectives, risk assessment and response. The Board and senior management oversee and examine the risk adjusted performance of the Group as a whole.

Execution of the approach is based on the premise that responsibility for risk taking rests with line management. They are accountable to the Board for maintaining an effective control environment that reflects risk appetite and business objectives. Management are required at regular intervals to report to the senior executive and the Board on the effectiveness of their risk management systems. Independent assessment of this process is provided by Group Audit and Credit Risk Review.

The three types of risks in our business, credit, market and operational risk, are discussed below.

Credit risk management

Credit risk is the risk of financial loss from the failure of a customer to honour fully the terms of its contract with Westpac. It arises not only from lending activities, but from any transaction which requires assured payment of funds on a given date. The process of controlling credit risk is integrated in the form of portfolio management.

Regular reviews of the portfolio are undertaken to guard against the development of risk concentrations. This process ensures that credit risk remains well diversified throughout the Australasian economy.

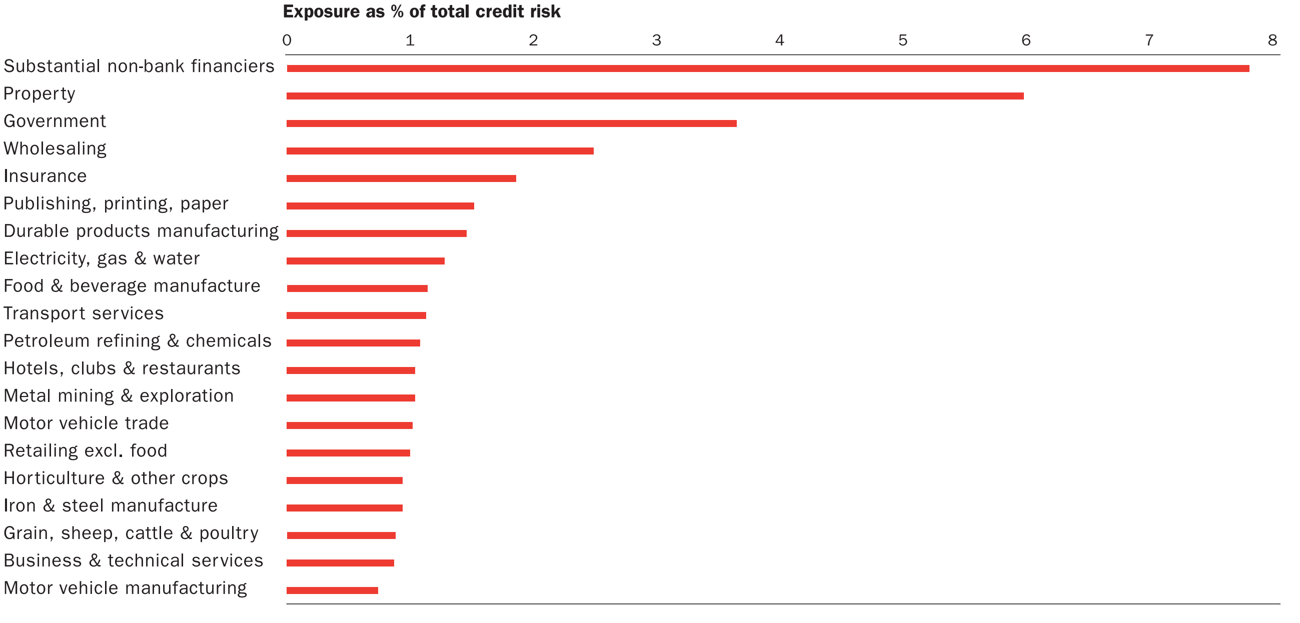
Expressed in terms of commitments, about one third of the risk involves consumers. This includes home loans, investment property loans to individuals, home equity loans, credit cards, finance company leases, personal loans, overdrafts and lines of credit. These customers are geographically diverse. Westpac has a substantial market share in every state in Australia, is one of the largest banks in New Zealand, and has a significant presence in the Pacific. These customers service their debts with income from a 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, about one eighth of the total, are to the world's banking institutions (380 banks in 54 countries). More than 90% of this exposure is to banks in twelve countries: Australia, New Zealand, Belgium, Canada, France, Germany, Netherlands, Japan, Singapore, Switzerland, the UK and the USA. As with all business loans, Westpac limits these commitments according to the credit ratings of the banks. Westpac has only modest exposure to those that do not have strong ratings, and exclude others altogether. Exposures to Japanese banks have reduced significantly over the last few years.

All other exposures, to non-banking businesses and governments, constitute approximately 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 (for example commodity price fluctuations or currency movements). As a result, customers in industries that might suffer from increased risk at the same time are monitored together. The volatility of each cluster is used to set maximum exposure guidelines, having regard to the diversification they provide for the portfolio as a whole. More volatile industries have lower exposure boundaries.

The industries in which the largest proportion of business customers operate are shown in the diagram below. As in previous years, some lending opportunities were not pursued during the year to avoid risk concentration.

Credit exposures to governments, corporations and businesses excluding banks



Westpac monitors exposures to countries in a similar way, having regard to the relevant sovereign credit ratings.

In addition to controls on industry and country risk concentrations, there are also separate controls on the amount of credit that can be accessed by a single customer group. Two levels apply, being maximum prudential limits and lower internal reporting limits. Excesses are reported quarterly to the Board Credit and Market Risk Committee, with a strategy for managing the excess. The limits are scaled by risk grade and separate limits apply to corporates, governments and financial institutions on the one hand, and banks on the other.

The emerging credit derivative market is offering banks a new way to manage the risks in its credit portfolio. Westpac has become an active participant in this market, both buying and selling protection. While these transactions have improved the diversification in the portfolio, the total value has not been sufficient to substantially alter the portfolio mix.

Asian exposures Westpac's total exposure to Asia was $6,874 million as at 30 September 1998, down 33% from $10,303 million as at 30 September 1997 (and down 14% from $7,960 million as at 31 March 1998). Exposure consisted of $2,351 million in on-balance sheet loans; $1,013 million in off-balance sheet, legally committed, but undrawn loan commitments; $614 million in off-balance sheet outstandings (principally guarantee and trade transactions) and $2,896 million in unfunded, pre-settlement risk exposure arising from foreign exchange and interest rate business, of which $1,425 million represents the replacement cost (positive mark-to-market) of amounts owed to Westpac by counterparties and $1,471 million representing an estimate of potential credit risk exposure arising from future movements in currency and interest rates over the life of the counterparty contracts. Virtually all of the exposure is with major banks in Japan, Singapore and Hong Kong.

Asian exposure by customer type

As at 30 September	Government $m	Banks and non-bank financial institutions $m	Corporate $m	Project Finance $m	**Total 1998 $m**	Total 1997 $m
Indonesia	29	39	23	106	**197**	197
Korea (South)	–	18	227	111	**356**	437
Thailand	–	21	25	34	**80**	190
Malaysia	–	7	97	2	**106**	90
Philippines	–	2	–	–	**2**	3
Sub-total	29	87	372	253	**741**	917
China/Hong Kong	–	696	385	42	**1,123**	907
Taiwan	–	32	11	1	**44**	44
Singapore	82	415	311	47	**855**	894
Japan	–	3,088	1,002	7	**4,097**	7,529
Other	–	10	–	4	**14**	12
Total	111	4,328	2,081	354	**6,874**	10,303

63% ($4,328 million) of total Asian exposure is to banks and financial institutions in Asia, 19% ($1,310 million) relates to exposure booked outside Asia, principally in Australia, and 14% ($966 million) relates to government and corporate exposures booked in Asia. 40% of exposures contractually mature within 6 months and 75% within 12 months.

Emerging markets exposure in Asia (Indonesia, South Korea, Thailand, Malaysia and the Philippines) represents only 11% of total Asian exposure ($741 million) with on-balance sheet loans (net of specific provisions) of $321 million representing just 3.3% of total shareholders' equity plus general provisions.

Dynamic provisioning for loan losses Westpac determines the reserves it holds to cover bad and doubtful debts by a statistical process called dynamic provisioning.

Dynamic provisioning estimates the level of future credit losses that may arise from loan portfolios to help ensure that appropriate provisions are maintained at all times. Statistical measures based on experience, supplemented by consideration of current market conditions, are used in estimating expected default rates and hence loss levels. 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.

The statistically expected loss consists broadly of two components, the probability that the customer will default, and the severity of the loss incurred when a default does occur. In the last year, Westpac refined its grading system to recognise the two components explicitly. The probability of loss is based on the historical default frequency of loans in each grade. The severity of loss is obtained by tracking a large number of defaulted loans, by the exposure and security, to measure the effectiveness and cost of the workout processes. This refinement enables the system to recognise risk more accurately so that more appropriate pricing for risk is now applied.

Dynamic provisioning is fully implemented in Westpac's internal management accounts. Consequently, a business unit which makes lower quality loans will incur a higher provisioning charge. Conversely, a shift to a higher quality business mix will require less provisions with the reduction credited to the unit's profit and loss statement. This encourages the business units to more accurately evaluate the risk in relation to the return generated by each new loan.

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

In its determination of the general provision level for September 1998, Westpac has allocated $20 million to cover risks arising from potential customer defaults in meeting credit obligations because of inadequate preparation for Year 2000 problems. Westpac will continue to re-assess the adequacy of this provision allocation as the millennium draws nearer.

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. Westpac uses a real time global limits system to record credit exposure against limits.

Foreign exchange and derivatives contracts involve two distinct elements of credit risk: pre-settlement risk and settlement risk.

Pre-settlement risk is the risk that the counterparty to a contract defaults before settlement and the value of the contract to Westpac is positive. 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 life of contract. 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 movement. This means that at any time over the contract's life, there is a probability of 84% that the 'worst case' estimates will not be exceeded. The sum of the current replacement cost and the potential future credit risk are used to measure exposure against limits.

Following the enactment of the Payment Systems and Netting Act 1998 on 2 July 1998, which gives legal certainty to the enforceability of close-out netting in Australia, Westpac implemented close-out netting. This covers foreign exchange forward and swap contracts for Westpac's counterparties where appropriate legally enforceable netting agreements are in place. In a close-out netting situation the positive and negative mark-to-market value of all contracts, in the event of default and regardless of their maturity, with the same counterparty are netted. If the netted exposure with a particular netting customer is positive, this means that Westpac has a credit risk exposure to that counterparty. Conversely, if the netted exposure is negative, Westpac's credit exposure to the counterparty is zero. Netting agreements and legislative enactments provide a high level of protection against a counterparty selectively honouring only those contracts in its favour in the event of default. Netting is only allowable for transactions and counterparties domiciled in an acceptable jurisdiction. Acceptable jurisdictions exist where there are appropriate legislation and corporate law frameworks which recognise the legal enforceability of netting agreements.

The table below summarises Westpac's foreign exchange and derivatives activity in notional amount, regulatory credit equivalent, replacement cost (positive mark-to-market) and negative mark-to-market terms. Westpac believes that the netted current credit exposure based on replacement cost of $10.4 billion more accurately reflects the credit risk from Westpac's foreign exchange and derivatives than the gross current credit risk exposure of $12.4 billion. The netting benefit from close-out netting is $2.0 billion and is not reflected in the financial statements. The financial statements comply with AASB1033 'Presentation and Disclosure of Financial Instruments', which does not permit such offsetting unless there is an intention to settle on a net basis.

Derivative dealing activity

As at 30 September 1998	Notional amount $bn	Regulatory Credit Equivalent $bn	Positive Mark-to-market $bn	Negative Mark-to market $bn
Gross trading derivatives (per note 30 to the financial statements)	533.8	18.4	12.4	11.6
Less: Netting benefit			(2.0)	(2.0)
Net trading derivatives	533.8	18.4	10.4	9.6

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 Moodys. Ratings of AAA, AA, A and BBB represent investment grade ratings and ratings of BB and below represent non-investment grade. The table below shows the credit quality of Westpac's current credit exposure risk associated with foreign exchange and derivatives. As at 30 September 1998, 97% (1997 98%) of current credit risk exposure was to investment grade customers.

Counterparty credit quality

Total assessed credit risk exposure as at 30 September	**1998 %**	1997 %
AAA, AA	**50**	50
A	**36**	41
BBB	**11**	7
BB and below	**3**	2
Total	**100**	100

The table below shows Westpac's current credit risk exposure by industry sector and by country of ultimate risk.

Counterparty credit risk by industry sector and by country of ultimate risk

Current credit risk exposure (net) as at 30 September 1998	Non-bank financial institutions $bn	Government $bn	Banks $bn	Others $bn	Total $bn
Australia	0.8	0.5	0.8	1.2	3.3
New Zealand	–	0.1	0.1	0.2	0.4
Europe	0.3	–	2.4	0.1	2.8
United States of America	0.8	–	1.3	0.2	2.3
Japan	0.2	–	1.0	–	1.2
Asia (excluding Japan)	0.1	–	0.1	–	0.2
Other	–	–	0.2	–	0.2
Total	2.2	0.6	5.9	1.7	10.4

Close-out netting has been applied to counterparties with appropriate netting agreements in legally enforceable jurisdictions.

The table below shows the maturity profile of Westpac's current credit risk exposure in gross replacement cost terms. The gross replacement costs overstates Westpac's current credit risk exposure as it ignores the netting benefit of $2.0 billion. The majority of foreign exchange and derivatives-related transactions are short term: 64% mature within 1 year and 73% within 2 years (63% and 75% respectively at 30 September 1997).

Credit risk maturity profile

Gross replacement cost as at 30 September 1998	Less than 3 months $bn	Over 3 months to 6 months $bn	Over 6 months to 1 year $bn	Over 1 year to 2 years $bn	Over 2 years to 5 years $bn	Over 5 years $bn	Total $bn
Interest rate							
Swaps	0.1	0.1	0.2	0.5	1.4	0.7	3.0
Foreign exchange							
Forwards	3.8	1.4	0.9	0.3	0.2	0.2	6.8
Swaps	0.1	0.2	0.5	0.2	0.6	0.1	1.7
Purchased options	0.4	0.1	0.1	0.1	0.1	0.1	0.9
Total derivatives	4.4	1.8	1.7	1.1	2.3	1.1	12.4

Settlement Risk occurs when Westpac pays out funds before it receives payment from the counterparty to the transaction. With the implementation of real-time gross settlement (RTGS) in Australia on 22 June 1998, settlement risk from inter-bank domestic high-value payments diminished as these payments are now settled on a real time basis. The RTGS system therefore has improved the liquidity and stability of the Australian financial sector. To reduce global settlement risk exposure, Westpac has expressed its intention to join ECHO, a multilateral clearing house designed to dramatically reduce global payment risk.

Market risk management

Market risk is the risk of earnings loss arising from adverse movements in the level and volatility of underlying market factors such as interest rates, foreign exchange rates, commodity and equity prices. Westpac is exposed to market risk as a consequence of its customer focus and its proprietary trading activities in financial markets; and through the asset and liability management of the overall balance sheet.

Management of market risk arising from trading and other banking activities is segregated.

Trading activities include Westpac's financial market 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 provides broad oversight over risk policies, methodologies and limits. A Trading Risk Committee, chaired by the Chief Credit Officer, ensures that Westpac's trading activities and new products are commensurate with Westpac's risk appetite. Market risk limits are allocated 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, regions and product groupings. A separate unit, Trading Risk Management, provides daily independent measurement and monitoring of market risk exposures against limits.

Daily earnings at risk Westpac uses earnings-at-risk (EAR) as the primary method for measuring and monitoring market risk exposure against Board approved limits. EAR is an estimate of the potential loss in earnings from an adverse market movement with a 99% one-tailed confidence level and a one day time horizon. This means that the actual daily loss can be greater than the EAR on average 1% of the time if Westpac's trading positions are held unchanged for one business day. EAR takes into account all material market variables that may cause a change in the value of the trading portfolio, including interest rates, foreign exchange rates and their volatilities, as well as correlation among these market variables.

Westpac has previously used an EAR model which was based on a variance-covariance approach. The EAR over the past two years using this method are presented in the table below.

	High		Low		Average	
	1998	1997	**1998**	1997	**1998**	1997
30 September	**$m**	$m	**$m**	$m	**$m**	$m
Interest rate risk	**7.8**	7.3	**1.6**	2.3	**3.7**	4.0
Foreign exchange risk	**7.0**	5.1	**1.3**	1.5	**3.3**	2.8
Other market risk[1]	**2.6**	2.1	**0.4**	0.8	**1.5**	1.3
Portfolio market risk	**12.6**	10.9	**4.3**	4.9	**7.7**	7.4

1 Commodity, equity, prepayment and specific issuer risk.

From 2 January 1998, Westpac has implemented a new internal model using historical simulation, for the calculation of EAR on its entire interest rate and foreign exchange trading portfolio. However, Westpac uses the standard regulatory model approach for its commodity and equity portfolios. These models are now used for internal modelling and regulatory purposes.

The following table depicts EAR during the six months ended 30 September 1998 using the historical simulation method. This method will be the primary monitoring and reporting method going forward. Any variation in the results reflects differences in methodology. The primary difference in the results represents the benefits of a larger portfolio diversification effect under the historic simulation.

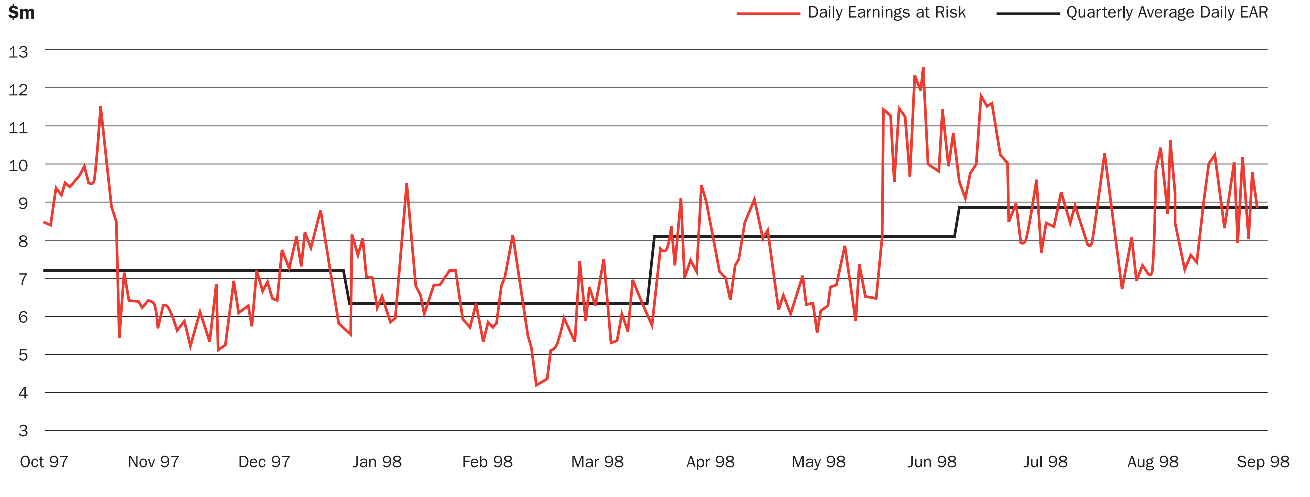
Six months ended 30 September 1998	**High $m**	**Low $m**	**Average $m**
Interest rate risk	3.9	0.7	1.9
Foreign exchange risk	4.2	0.5	1.9
Volatility risk	1.6	0.1	0.4
Other[1] market risk	2.6	1.9	2.1
Aggregate market risk	9.2	4.0	6.3

1 Commodity, equity, prepayment and specific issuer risk.

The increase in market risk levels in 1998 is consistent with Westpac's overall strategy of increasing risk income from the financial markets business within prudent exposure limits.

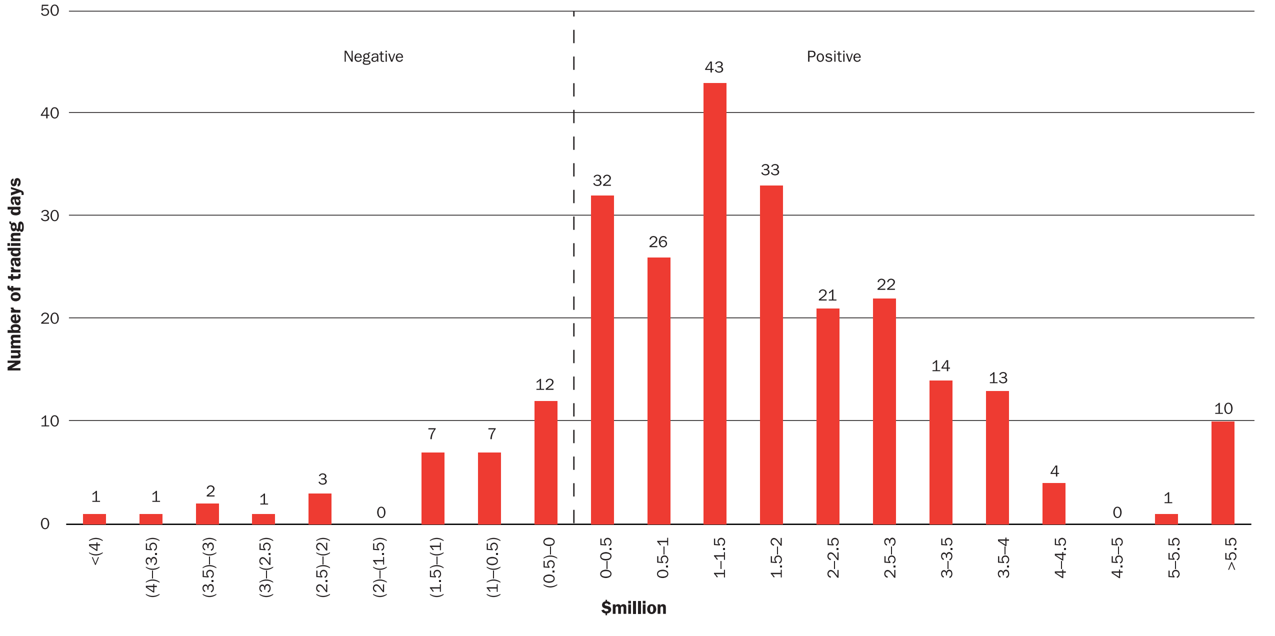
The following graph shows the aggregate daily EAR for the twelve months to 30 September 1998 using the variance-covariance approach.

Daily earnings at risk



Market volatility experienced during the year did not adversely impact Westpac's daily trading income performance which is graphed below.

Distribution of daily trading income



In addition, the trading risk management team performs regular stress testing on Westpac's trading portfolio to quantify the impact of extreme movements in market factors such as shifts in interest rates, currencies and volatilities and scenarios such as a shift in Australian monetary policy, currency crisis, global funding squeeze, bond market instability and expansion of corporate bond spreads.

Westpac also uses structural limits (such as volume limits) and advice of loss limits to manage the market risk of its trading portfolio. Advice of loss procedures ensure that significant losses (should they occur) are promptly communicated to senior management.

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 in 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 was introduced, 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:

i) underlying balance sheet data with assumptions about new business (derived from the Group's internal forecast process);

ii) the expected repricing behaviour of the Group's various lending and deposit benchmark rates; and

iii) 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 1998, 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 99% 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 its 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 the Group Asset and Liability Committee (ALCO) on a monthly basis.

Operational risk management

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. Risk management techniques utilised by Westpac 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. Operational risk is assessed under six headings:

- 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:

- The principles of clear delegation of authority and segregation of incompatible duties are fully reflected in Westpac's operating processes. The centralised operation of many back office processes into centralised sites facilitates greater opportunity for 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 and capability of Westpac staff is critical for the effective management of operational risk. Ongoing training and career development 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;
- The operational risk framework tracks key predictive indicators. These include analysis of business planning and variance, market share, 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; and
- Westpac maintains insurance policies to provide protection from losses arising from circumstances such as fraud, fidelity, forgery, theft, counterfeiting, legal liability for third party loss, and loss due to damage or destruction of physical assets.

During 1998 and going into 1999 some of the areas of operational risk focus are:

Year 2000 project

As at 30 September 1998, 95% of core systems have been rectified and the contingency planning phase has commenced.

Westpac's preparations include:

- ensuring substantially all critical systems will be compliant by 31 December 1998;
- planning and development of internal, global and industry-wide testing of payment and data exchange systems;
- working with our critical suppliers, customers and other business relationships on Year 2000 preparations;
- extending existing business contingency planning to support continuity of customer service into the next millennium;
- reporting our progress regularly to the Australian Prudential Regulation Authority, the Australian Stock Exchange and liaising with governments, industry bodies and regulators around the globe.

During 1999, the focus of the Year 2000 project will increasingly concentrate on the complexities of internal, global and industry-wide testing, premises remediation and contingency measures. Westpac now estimates total remediation costs of $85 million for the Year 2000 project. To the maximum extent possible, the project continues to use existing Westpac resources.

The increased cost of remediation for Year 2000 is due to three factors:

- expansion of the scope of the project – the initial estimate of costs related to core information technology systems. Premises and other business technology costs have now been included;
- increases in cost estimates – some costs have been higher than expected upon detailed assessment of the extent of the work; and
- opportunities for enhancement being identified – opportunities have been taken to upgrade, replace and improve some applications and facilities.

Westpac intends to be ready for Year 2000. Information on our progress is available through our web site www.westpac.com.au or Westpac Helpdesk on 132 032.

Introduction of the Euro

Westpac will be ready to trade the euro on its introduction at 1 January 1999. The impact of the introduction of the euro on Westpac is not material with only 11% of foreign exchange related transaction volumes conducted in the existing legacy currencies, largely as a result of the strategic focus of concentrating on AUD/NZD flows. It is not anticipated that the introduction of the euro will have a significant impact on how Westpac conducts its global business. The general approach Westpac has adopted is to leave existing legacy transactions in place (89% of which mature within 6 months) to mature and to book new trades in euro. The main risk to the bank is an inability to consolidate the legacy positions to one euro position. This is not considered to be a significant risk given the magnitude of legacy positions and the contingency arrangements that the bank has in place.

Integrating acquisitions

The integration of Bank of Melbourne follows the integration of Challenge Bank in Western Australia and the recently completed integration of Trust Bank New Zealand.

The merger with Bank of Melbourne is progressing as planned with full state-wide integration of branches, products and systems to be implemented in late 1998, whereby all Bank of Melbourne customers will be able to access Westpac's full services nationally. Customer retention has been a key focus with no major losses of retail customers recorded to date.

Since the merger announcement, detailed planning has identified additional synergy benefits for marginal additional expenditure on technology and network infrastructure. Synergy benefits are now estimated at $95 million per annum with total estimated integration costs of $180 million. Synergy benefits in the period ending 30 September 1998 total $29 million with $100 million of integration costs incurred to date, of which $23 million has been expensed during the year. These synergy benefits have primarily been achieved through the centralisation of head office functions, and the rationalisation of information technology processes including the infrastructure supporting ATMs and telephone banking.

Capital adequacy and risk-weighted assets

Eligible capital and relevant ratios

As at 30 September	1998 $m	1997 $m
Tier 1 capital		
Total shareholders' equity	**8,611**	8,206
Asset revaluation reserves	**(144)**	(202)
Intangible assets	**(1,788)**	(1,029)
Future income tax benefit net of deferred tax liability	**(24)**	(11)
Total tier 1 capital	**6,655**	6,964
Tier 2 capital		
Premises revaluation reserves	**144**	202
Subordinated undated capital notes	**745**	695
General provision for bad and doubtful debts	**1,238**	1,249
Future income tax benefit related to general provision	**(446)**	(450)
Eligible subordinated bonds, notes and debentures	**1,390**	1,021
Total tier 2 capital	**3,071**	2,717
Tier 1 and tier 2 capital	**9,726**	9,681
Deductions:		
Other banks' capital instruments	**(9)**	(9)
Investment in controlled entities or associates[1]	**(380)**	(346)
Capital in funds management and securitisation activities[2]	**(198)**	(209)
Net qualifying capital	**9,139**	9,117
Risk adjusted assets	**97,430**	87,133
Tier 1 capital ratio	**6.8%**	8.0%
Tier 2 capital ratio	**3.2%**	3.1%
Deductions	**(0.6)%**	(0.6)%
Net capital ratio	**9.4%**	10.5%

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

2 This deduction has been made pursuant to the APRA 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.

Risk-weighted assets

	Balance			Risk-weighted Balance	
	1998 $m	1997 $m	Risk-weight %	1998 $m	1997 $m
On-balance sheet assets					
Cash, claims on RBA, Australian Commonwealth Government securities under one year and other zero-weighted assets[1]	**26,499**	15,296	0%	–	–
Other claims on Australian Commonwealth Government, claims on state governments, OECD governments and central banks, and money market dealers	**629**	3,590	10%	**63**	359
Claims on OECD banks and local governments	**2,899**	5,590	20%	**580**	1,118
Loans secured by residential mortgages	**51,774**	40,152	50%	**25,887**	20,076
All other assets	**55,518**	54,335	100%	**55,518**	54,335
Total on-balance sheet assets – credit risk	**137,319**	118,963		**82,048**	75,888

	Contract or Notional Amount		Credit Equivalent Amount		Risk-weighted Balance	
	1998 $m	1997 $m	1998 $m	1997 $m	1998 $m	1997 $m
Total off-balance sheet exposures – credit risk	**607,671**	554,233	**32,747**	24,789	**14,846**	11,245
Total risk-weighted assets – credit risk					**96,894**	87,133
Risk-weighted assets – market risk					**536**	n/a
Total risk-weighted assets					**97,430**	87,133

1 Other zero-weighted assets include gross unrealised gains on trading derivative financial instruments of $12,391 million (1997 $8,709 million).

The Australian Prudential Regulation Authority (APRA) was established on 1 July 1998 and took responsibility for the prudential supervision of deposit taking institutions, life and general insurance companies and superannuation funds. This role in relation to banks was previously undertaken by the Reserve Bank of Australia (RBA). The prudential standards which the RBA had applied to banks in Australia have been adopted by the APRA.

Australia's risk-based capital adequacy guidelines 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 basically consists of 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 are made for holdings of other banks' capital instruments and capital invested in non-consolidated subsidiaries, such as general and life insurance subsidiaries. From October 1995, banks have also been required to deduct any capital invested or guarantee provided to subsidiaries involved in funds management or the securitisation of assets. 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-weighted 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 that asset. 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 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 other 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; except where the loan is 100% mortgage insured through an acceptable lender's mortgage insurer. 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 normally applies.

Effective from 2 January 1998, the APRA also requires Australian banks to hold additional capital against market risk.

At 30 September 1998, Westpac's tier 1 and total capital ratios were 6.8% and 9.4% respectively, well in excess of the APRA's minimum requirement.

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 APRA's guidelines do not so qualify under United States' guidelines;

ii) under the APRA's guidelines, the general provision for doubtful debts, net of associated future income tax benefits, qualifies as tier 2 capital. Under United States' guidelines, the associated future income 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 income tax benefit exceeds off-setting deferred tax liabilities; and

iii) the United States' guidelines allow net future income 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 43 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 at 30 September 1998, in accordance with United States' guidelines, was 7.1% and 10.5% respectively.

Corporate governance

Westpac is a major participant and competitor in Australia's financial services sector. It is committed to delivering the best results to all of its stakeholders, in particular its shareholders, its customers and its staff.

The Westpac Deed of Settlement

The first bank to be established in Australia, Westpac, originally the Bank of New South Wales, 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 181 years, been subject to a number of amendments. As the Bank's constitution, it 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 Group's activities are also regulated by much of the Corporations Law.

Board governance practices

Overview The Directors' principal objective is to maintain and increase shareholder value while ensuring that the Group's overall activities are properly managed.

Directors are committed to best practice corporate governance which ensures an ethical framework within which there is public accountability and a fully informed market. The Board's overall responsibilities include:

- approving corporate strategies and monitoring managerial performance;
- monitoring financial performance and in this regard, working with the Group's external auditors; and
- monitoring and ensuring the maintenance of adequate risk management controls and reporting mechanisms.

Size and composition The Board determines its own size as allowed by the Deed. The Deed provides that the minimum number of Directors be seven, and the maximum 15. Three of its number may be executive Directors. At present the Board has 14 Directors, 11 of whom are non-executive Directors. Details relating to the present members of the Board are set out in the Directors' report at page 78.

Independence The Chairman of the Board is a non-executive Director, appointed by the full Board. The predominance of non-executive Directors and a non-executive Chairman ensures the independence of the Board from Westpac's executive management.

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, on approval by the Board.

Nominations Nominations for appointment to the Board are considered by the Board as a whole. In selecting suitable Board candidates, the Board takes into account the existing diversity of experience among the current Board and selects candidates accordingly. An important quality sought, regardless of diversity of experience, is a proven track record in decision-making, usually at a senior executive level.

Performance The performance of executive Directors (along with other senior executives) is reviewed periodically by the Board Remuneration Committee and the full Board. The performance of non-executive Directors is reviewed by the Chairman on an ongoing basis. The Chairman's performance is reviewed by the full Board each year prior to the appointment of a Chairman.

Retirement 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.

Meetings The Board meets formally on at least 10 occasions during the year. Meeting agendas are settled by the Chairman and the Chief Executive Officer to ensure adequate coverage of financial, strategic and major risk areas throughout the year. Details of meetings and attendances are set out at page 84.

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. The pool limit is not at present fully utilised. In setting Directors' fees, account is taken of the responsibilities inherent in the stewardship of the company and the demands made of Directors in the discharge of their responsibilities. Advice is taken from independent consultancy sources to ensure remuneration accords with market practice. Details of fees and other entitlements paid to Directors are set out in full in the Directors' report and in note 39 to the financial statements.

Ethics Ethical business conduct is expected of all Westpac people. They are expected to work within the Westpac Code of Conduct's five key principles:

- acting with honesty and integrity;
- abiding by laws and regulations;

- respecting confidentiality and the proper handling of information;
- avoiding conflicts of interest; and
- striving to be a good corporate citizen and achieve community respect.

In addition to its Code of Conduct, Westpac also has in place a number of specific policies underpinning the Code. These support the maintenance of business ethics, including those governing workplace and human resources practices, handling of personal information, insider trading, risk management and legal compliance.

Insider trading

Directors are subject to restrictions under the Corporations Law relating to dealings in securities. In addition to these restrictions, the Board's policy is that Directors may only buy or sell Westpac shares or options, after notifying the Chairman, in the six weeks immediately following Westpac's half year and full year financial results announcements and, if relevant, any Annual General Meeting announcement. At all other times the Board must receive prior notice of transactions involving Westpac shares and the transactions are subject to Board veto.

Board Committees – functions and responsibilities

The Board uses committees to support it in matters which require more intensive review. At present the Board has three committees. All three committees are comprised of non-executive Directors and membership is reviewed and rotated on an ongoing basis. Executive Directors and senior executives may also be invited to attend the meetings of committees.

The Board Audit Committee The functions of the Board Audit Committee are set out in the Deed and in the Committee's Terms of Reference, as approved by the Board. It considers all matters concerning accounting and financial reporting including reviewing the interim and annual financial statements. The Committee monitors the relationship with the external auditors and makes recommendations to the Board on the appointment and removal of external auditors, their terms of engagement, and the scope and quality of the audit. Additionally, the Committee sets the scope of the internal audit functions and ensures its resources are adequate. The Committee also reviews internal risk controls and Westpac's control environment in relation to operations, financial reporting and legal/regulatory compliance.

Present membership of the Committee: Mr J.P. Morschel (Chairman), Mr I.R.L. Harper, Ms H.A. Lynch and Mr J.A. Uhrig (ex officio). During 1998 Mr W.B. Capp, Sir Llewellyn Edwards and Mr P.D. Ritchie also served on the Committee.

Board Credit and Market Risk Committee The Credit and Market Risk Committee oversees matters relating to Westpac's 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 and risk position authority to the Managing Director and Chief Credit Officer and monitors the credit and market risk performance of management through management reports and the independent reports of Credit Risk Review. The Committee's powers and procedures are governed by the Deed and the Committee's Terms of Reference, as approved by the Board. Detailed discussion of credit and market risk is contained in the financial review section starting at page 63.

Present membership of the Committee: Professor W.P. Hogan (Chairman), Mr J.B. Fairfax, Ms E. Mahlab, Mr C.J. Stewart and Mr J.A. Uhrig (ex officio).

Board Remuneration Committee 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 Terms of Reference, as approved by the Board. The Committee's work is supported by independent remuneration consultants to ensure that Westpac's remuneration practices are within market practice.

A fuller discussion of Westpac's remuneration philosophy forms part of the Director's report at page 78.

Present membership of the Committee: Mr W.B. Capp (Chairman), Sir Llewellyn Edwards, Mr P.D. Ritchie and Mr J.A.Uhrig (ex officio). During 1998 Professor W.P. Hogan and Ms E. Mahlab were also members of the Committee.

Regional advisory boards

In Western Australia, Victoria and New Zealand, where Westpac's operations are conducted through regional brand names, 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.

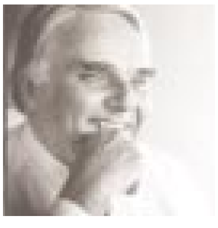
Western Australia – Challenge Bank During 1998 membership of the Advisory Board comprised: Mr R.E. Argyle (Chairman), Mr A.E. Blanckensee and Mr H.W. Sorensen.
Victoria – Bank of Melbourne During 1998 membership of the Advisory Board comprised: Mr C.J. Stewart (Chairman), Mr M.A. Gray and Professor R.R. Officer.
New Zealand – WestpacTrust During 1998 membership of the Advisory Board comprised: Mr B.N. Kensington (Chairman), Mr J.C. King, Mr J.W. Walden, Ms S.H. Suckling, Mr I.F. Farrant, Dr T.B. Layton, Mr G.S. Pentecost and Mr P.D. Wilson.

Barry Capp BE(Civil), BCom, BA. Age 65.
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, Hawthorn International Education Limited, Melbourne University Private Limited, Tassal Limited, Hellaby Holdings Limited and Hillside Trains Corporation.

The Hon. Sir Llewellyn Edwards AC, MB, BS, FRACMA, LLD(h.c.), FAIM. Age 63.
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). Director of James Hardie Industries Limited and TCNZ Australia Pty. Limited. He also acts as a consultant to business and government.

John Fairfax AM. Age 56.
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.

Patrick Handley Age 53.
Executive Director since November 1997. Patrick Handley joined Westpac in 1993 with 23 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 Chief Financial Officer of Westpac, with responsibility for finance, taxation and accounting, group treasury, information technology, public and consumer affairs, and investor relations.



Ian Harper AM, BA, LLB. Age 66.
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, former President and continuing Member 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 69.
Director since 1986. He was a member of the Board of The Australian Mutual Provident Society between 1993 and 1995. Warren Hogan was Professor of Economics at the University of Sydney from 1968 to 1998. He is an Adjunct Professor in the Faculty of Business of the University of Technology, Sydney. Adviser to business, government and international organisations including the World Bank, Harvard University Development Advisory Service and the Australian Stock Exchange Limited.

Robert Joss Age 57.
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 and a Trustee of the National Parks and Wildlife Foundation of New South Wales.

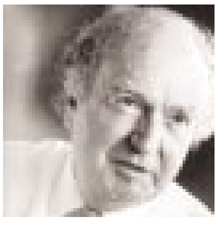
Helen Lynch **AM. Age 55.**
Director since November 1997. Helen Lynch had 35 years' experience in Westpac including membership of Westpac's executive team before retiring in 1994. She is Chairman of the Superannuation Funds Management Corporation of South Australia and a Director of Coles Myer Limited, Southcorp Holdings Limited and OPSM Protector Limited. She is also Director of the Centre for Independent Studies and The Garvan Medical Research Institute. In 1997 she was appointed a delegate to the Constitutional Convention.

Eve Mahlab **AO, LLB. Age 61.**
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. Deputy Chairman of Film Australia Limited, Board Member of Walter and Eliza Hall Institute of Medical Research.

David Morgan **BEc, MSc, PhD. Age 51.**
Executive Director since November 1997. David Morgan has extensive experience in the financial sector, having worked in the International Monetary Fund in Washington D.C. 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 had responsibility for all major operating divisions including Westpac Financial Services, Retail Banking, Commercial Banking, Corporate and Institutional Banking and International Banking. His current areas of responsibility are Corporate and Institutional Banking, International Banking and Westpac Financial Services.

John Morschel **DipQS, AAIQS, FAIM. Age 55.**
Director since July 1993. John Morschel has broad experience in the property and construction industries and the life insurance and financial services industry. Chairman Comalco Limited, Director of CSR Limited and Tenix Pty. Limited. Trustee of the Art Gallery of New South Wales.

Peter Ritchie **BCom, FCPA. Age 56.**
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.



Christopher Stewart **Age 70.**
Director since November 1997. Christopher Stewart was Chairman of the Bank of Melbourne Limited from 1989 to 1998. 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 to 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.

John Uhrig **AO, BSc, DUniv, Hon. Decon, FAIM. Age 70.**
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.

Directors' report

The Directors of Westpac Banking Corporation present their report together with the financial statements of Westpac Banking Corporation (the 'Parent Entity') and of the Economic Entity, being the Parent Entity and its controlled entities (collectively referred to as the 'Group') for the financial year ended 30 September 1998.

Directors

The names of the persons who have been Directors of the Parent Entity during the period since 1 October 1997 are Mr J.A. Uhrig (Chairman), Mr W.B. Capp, The Hon. Sir Llewellyn Edwards, Mr J.B. Fairfax, Mr R.P. Handley, Mr I.R.L. Harper, Professor W.P. Hogan, Mr R.L. Joss (Managing Director), Ms H.A. Lynch, Ms E. Mahlab, Dr D.R. Morgan, Mr J.P. Morschel, Mr P.D. Ritchie and Mr C.J. Stewart. Particulars of their qualifications, experience and special responsibilities are set out under the headings 'Board of Directors' on pages 76 and 77 and 'Corporate Governance' on pages 74 to 75 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 1998, 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 84 of this report.

Principal activities

The principal activities of the Group during the financial year which ended on 30 September 1998 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.

Review and results of operations

A comprehensive review of the operations of the Group for the financial year ended 30 September 1998 is set out on pages 6 to 11 and 50 to 73 and forms part of this report.

The operating result of the Group attributable to shareholders for the financial year ended 30 September 1998 was a profit of $1,272 million.

Dividends

A final dividend for the financial year ended 30 September 1997 of 20 cents per fully paid ordinary share, totalling $379 million, was paid by the Parent Entity on 5 January 1998, as a fully franked dividend. Of that amount, $354 million had been provided for in the financial statements for the year ended 30 September 1997.

An interim dividend for the financial year ended 30 September 1998 of 21 cents per fully paid ordinary share, totalling $388 million, was declared by the Directors and paid as a fully franked dividend on 3 July 1998.

A final dividend for the financial year ended 30 September 1998 of 22 cents per fully paid ordinary share, estimated amount $418 million, has been provided in the financial statements for that year and will be paid on 4 January 1999 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 31 December 1997 as a fully franked dividend. Of that amount, $10 million had been provided in the financial statements for the year ended 30 September 1997.

A dividend at the rate of 24.375 cents per converting preference share, total amount $15 million, was paid on 30 June 1998 as a fully franked dividend.

Details of dividends provided for or paid, including preference dividends, are set out in note 7 to the financial statements.

Significant changes in state of affairs

Significant changes in the state of affairs of the Group during the financial year were as follows:

Capital management On 3 November 1997, the on-market buy-back scheme announced on 19 May 1997 concluded. Approximately 21.9 million fully paid ordinary shares were repurchased under the scheme at an average price of $8.32 per share.

On 17 November 1997, the previously announced on-market buy-back of 85 million, or approximately 5%, of the Parent Entity's fully paid ordinary shares was commenced. On 15 May 1998, this buy-back concluded with 80 million shares having been repurchased at an average price of $10.04 per share.

On 31 December 1997, at the election of the Parent Entity, 20 million, or 25%, of the Parent Entity's fully paid converting preference shares were converted to fully paid ordinary shares on a 1:1 basis.

On 22 May 1998, the previously announced on-market buy-back of an aggregate of up to 60 million, or approximately 3.1%, of the Parent Entity's fully paid ordinary shares and converting preference shares was commenced. As at 11 November 1998, 34.4 million fully paid ordinary shares had been repurchased at an average price of $10.05 per share.

On 30 June 1998, the remaining 60 million of the Parent Entity's fully paid converting preference shares were mandatorily converted to fully paid ordinary shares on a 1:1 basis.

During 1998, the securitisation program continued. There were two significant transactions. The first was a $260 million Mortgage Backed Securities (MBS) issue into the Australian capital markets backed by New Zealand mortgages from WestpacTrust. This was seen to be an important part of the overall balance sheet management strategy for New Zealand.

The second transaction was a $2.2 billion (US$1.4 billion) global MBS issue. This was the first global asset backed issue out of Australia, the largest debt financing by an Australian corporation, and the first asset backed transaction involving non-US assets to be registered with the US Securities & Exchange Commission.

Bank of Melbourne The Bank of Melbourne merger scheme of arrangement received final approval from the Victorian Supreme Court on 17 October 1997, by which time all regulatory approvals were to hand. Legal integration of the two entities was achieved on 3 May 1998. Business integration is expected to be completed by 23 November 1998.

Directors Mr John Morschel resigned as an Executive Director and was appointed as a non-executive Director, effective 12 November 1997. Ms Helen Ann Lynch and Mr Christopher John Stewart were appointed as non-executive Directors, effective 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, effective 12 November 1997, following the adoption of the 1997 financial statements.

Events after end of financial year

The Directors are not aware of any matter or circumstance that has arisen since 30 September 1998 which 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, in future financial years.

Likely developments and expected results

Likely major developments in the operations of the Group in future financial years and the expected results of those operations are referred to in pages 6 to 41 and form part of this report.

Directors' interests in securities

Particulars of:

i) relevant interests in shares of the Parent Entity or any related body corporate;

ii) relevant interests in debentures of, or interests in any registered managed investment scheme made available by the Parent Entity or any related body corporate; and

iii) rights or options over shares in, debentures of or interests in any registered managed investment scheme made available by the Parent Entity or any related body corporate, held by Directors of the Parent Entity, together with details of any contracts to which those Directors are a party or under which they are entitled to a benefit and which confer a right to call for or deliver:

  a) shares in;

  b) debentures of; or

  c) interests in any registered managed investment scheme made available by the Parent Entity or any related body corporate, are as follows:

Directors' holdings of Westpac shares as at 11 November 1998

Name	Number of Ordinary Fully Paid Shares and Options	Non-beneficial[1]
J. A. Uhrig	53,000	298,017
W. B. Capp	12,890	
Sir Llewellyn Edwards	8,493	
J.B. Fairfax	100,000	231,943
R.P. Handley	1,000,000 700,000[3]	
I.R.L. Harper	39,516	285,017
W.P. Hogan	14,066	
R.L. Joss	1,416,667 5,433,334[2]	
H.A. Lynch	8,174	
E. Mahlab	10,729	285,017
D.R. Morgan	649,732 875,000[3]	
J.P. Morschel	4,000	
P.D. Ritchie	21,164	15,000
C.J. Stewart	150,075	

1 Certain of the Directors have relevant interests in shares, and shares subject to warrants, held beneficially by staff-related funds of which those Directors are either personal trustees or Directors of corporate trustees.
2 Options issued under the Chief Executive Share Option Agreement.
3 Options issued under the Senior Officer's Share Purchase Scheme.

Other disclosable interests as at 11 November 1998

Mr R.P. Handley – AGC Money Market Access account $363,618.
Mr R.L. Joss – AGC Money Market Access account $164,458.
Dr D.R. Morgan – Westpac Australian Tax Effective Share Fund $43,492.

Share options

Information about unissued shares or unissued interests relative to 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.

Remuneration philosophy and practice

Non-executive Directors 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. The pool limit is not at present fully utilised. In setting Directors' fees, account is taken of the responsibilities inherent in the stewardship of the company and the demands made of Directors in the discharge of their responsibilities. Advice is taken from independent consultancy sources to ensure remuneration accords with market practice. Income received, or due and receivable, from the Parent Entity and related entities by non-executive Directors of the Parent Entity for the year ended 30 September 1998 was:

	Fees $	Superannuation Guarantee Charge $	Total Cost $
J.A. Uhrig (Chairman)	260,000	6,308	266,308
W.B. Capp[1]	75,000	5,005	80,005
Sir Llewellyn Edwards	65,000	4,338	69,338
J.B. Fairfax	65,000	4,338	69,338
I.R.L. Harper[1]	75,000	5,005	80,005
W.P. Hogan[1]	69,824	4,493	74,317
H.A. Lynch[2]	57,597	9,839[5]	67,436
E. Mahlab	65,000	4,338	69,338
J.P. Morschel[1,3]	62,421	2,915	65,336
P.D. Ritchie	65,000	3,900	68,900
C.J. Stewart[2]	57,597	2,760	60,357
C.J. Stewart[4]	103,125	6,604	109,729

1 Includes fees payable to Chairmen of Board Committees.
2 Appointed 12 November 1997.
3 Resigned as an executive Director and appointed a non-executive Director on 12 November 1997.
4 Compensation received as Chairman of Bank of Melbourne.
5 Includes, in addition, fee for service on a Bank committee.
Note: Remuneration for executive Directors is disclosed as part of remuneration details for the top five senior executives at page 82.

Executive Directors and Senior Executives Westpac has designed its executive compensation program to support a pay for performance policy that differentiates compensation amounts based on an evaluation of performance results in three basic areas: corporate, business unit and individual; and which differentiates the composition of compensation into three types: base salary, annual performance bonus, and long-term incentives. The program is administered by the Board Remuneration Committee, which is composed of non-executive Directors.

In combination, these three compensation types comprise total reward. For better performers, total reward is matched to the upper quartile of the market, reflecting a target mix of fixed pay, variable pay and share option value.

The Committee takes into account the recommendations of the Chief Executive Officer with respect to the compensation of Westpac's key executives. In making recommendations, the CEO receives assessments and advice from independent compensation consultants regarding the compensation practices of Westpac and others. However, the Committee makes the final compensation decisions concerning these officers.

The Committee's specific objectives are to:

- Align the financial interests of executive officers with those of shareholders by providing significant Westpac equity-based long-term incentives. Share options are awarded to link a significant portion of senior management compensation to the attainment of sustained growth in shareholder value. Award levels are determined according to the individual's responsibility, performance and potential to enhance shareholder value. The Committee uses the Black & Scholes option pricing model to establish the appropriate value of the long-term incentive;
- Provide annual variable compensation awards that:
  a) reward and motivate executives for the achievement of strategic business unit initiatives in a given year, in keeping with Westpac's pay for performance philosophy;
  b) take into account Westpac's overall performance relative to corporate objectives and performance of the peer group (being Australian and international banks with similar asset bases and market capitalisation); and
  c) are based on individual contributions and business unit results that help create value for Westpac's shareholders;

• Provide fixed pay (base salaries) to attract and retain key executives who are critical to the Bank's long term success by providing a secure level of income that recognises the market value of the position as well as internal equities between roles, the individual's performance and experience. Base pay for management typically approximates the median salary for positions of similar responsibility in the peer group. Generally, increases in base pay only occur in response to market changes or when warranted by an executive's change in responsibilities. Consistent with this and the strategy to place less emphasis on base pay, individual salary adjustments in 1998 were limited to those executives with salaries significantly below the median salaries paid by the peer group; and

• Emphasise performance-based and equity-based compensation as executive officer level increases.

During the 1998 financial year, 13,551,000 options were issued to 528 eligible officers.

Details of the nature and amount of each element of the emolument of each of the five most senior executives for the year ended 30 September 1998 was:

Name & Position	Year	Base Pay[1] $	Bonus[1] $	Total Cash Compen-sation $	Other Compen-sation[2] $	Total Compen-sation[3] $	Option Grants No. of shares[4]	Exercise Price $	Date First Exercisable
R.L. Joss	**1998**	**920,548**	**1,000,000**	**1,920,548**	**481,842**	**2,402,390**	**700,000**	**10.27**	**27-Jan-99**
Managing Director							**700,000**	**10.27**	**27-Jan-00**
and CEO[a]							**700,000**	**10.27**	**27-Jan-01**
	1997	750,000	750,000	1,500,000	428,745	1,928,745	–	–	–
R.P. Handley	**1998**	**685,000**	**550,000**	**1,235,000**	**134,583**	**1,369,583**	**–**	**–**	**–**
Executive Director and Chief Financial Officer[b]	1997	574,270	350,000	924,270	65,525	989,795	500,000	7.89	29-Sep-00
D.R. Morgan	**1998**	**600,000**	**550,000**	**1,150,000**	**8,995**	**1,158,995**	**–**	**–**	**–**
Executive Director	1997	509,603	375,000	884,603	7,402	892,005	500,000	7.89	29-Sep-00
IIBG[c]							175,000	7.10	28-Jan-00
R.W. Nimmo	**1998**	**539,650**	**270,000**	**809,650**	**91,631**	**901,281**	**–**	**–**	**–**
Group Executive and Chief Credit Officer[d]	1997	493,210	180,000	673,210	110,169	783,379	360,000	7.10	28-Jan-00
M.J. Hawker	**1998**	**416,260**	**400,000**	**816,260**	**9,065**	**825,325**	**–**	**–**	**–**
Group Executive	1997	355,753	350,000	705,753	20,447	726,200	300,000	7.89	29-Sep-00
and Chief Executive Officer NSW[e]							160,000	7.10	29-Jan-00

1 Base pay has been received in the year to 30 September; bonus figures reflect amounts accrued but not yet paid in respect of the year ended 30 September.

2 Other compensation is stated on a cost to the company basis, which may be more than the actual value received by the Executive and includes contractual obligations such as:

a Superannuation, personal and family travel, health insurance and housing (Executive incurs unreimbursed personal housing expenses for a foreign residence).

b Health insurance, personal and family travel, taxation advice and housing (Executive incurs unreimbursed personal housing expenses for a foreign residence).

c Car parking.

d Superannuation, concessional lending, taxation advice and travel.

e Concessional lending (housing) and car parking.

3 Figures do not include fringe benefits tax, other than for those individuals whose remuneration is calculated on a 'total employment cost' basis.

4 Option grants are a right to buy ordinary shares at an exercise price equal to the market value on the day prior to the date of offer. For Executives other than Mr Joss the options have a maximum term of five years and are exercisable after three years. The options granted to Mr Joss are provided in three tranches, each of 700,000 options, first exercisable 27 January 1999, 27 January 2000 and 27 January 2001 respectively. Mr Joss' right to exercise each tranche of options will require him to be employed at Westpac on the first exercise date for each tranche. In addition, the Westpac share price must exceed $10.93, $11.64 and $12.40 respectively on the day of exercise of the option.

Note: The table discloses remuneration paid to the five most senior policy makers within the Bank. Other individuals who are rewarded under incentive-based systems according to results, consistent with market practice within the industry, may within any given year receive remuneration at a level in excess of that received by some Executives shown above.

Indemnities and insurance

Unless arising out of conduct involving a lack of good faith, under Westpac's Deed the Parent Entity must indemnify, to the extent permitted by law, each director, secretary, executive officer and employee of members of the Group against:

i) any liability incurred by each such person in their capacity as director, secretary, executive officer or employee, as the case may be; and

ii) any liability incurred:
   a) in defending civil or criminal proceedings in which judgment is given in their favour;
   b) in which they are acquitted;
   c) in connection with any application relating to such proceedings in which relief is granted to them under the Corporations Law or the corresponding law of another jurisdiction; or
   d) in connection with any investigation of any kind relating to the affairs or conduct of the Parent Entity or any member of the Group in which they are examined or required to give evidence or produce documents.

Each of the Directors named on pages 76 and 77 of this report and the Secretary of the Parent Entity, Ms B.A. McNee, has the benefit of this indemnity, which extends to all directors, secretaries, executive officers and employees of each member of the Group.

Auditors of the Parent Entity are also indemnified under the Deed of Settlement on terms identical to those set out in paragraph ii) above.

No amount was paid under these indemnities during the financial year ended 30 September 1998 or since that date.

The Deed permits the Parent Entity to pay or agree to pay premiums in respect of any contract of insurance which insures any person who is or has been a director, secretary, executive officer or employee of any member of the Group against any liability incurred by that person in any such capacity and being a liability:

i) for costs and expenses in defending proceedings (whether civil or criminal), whatever their outcome; and

ii) not arising out of conduct involving a wilful breach of duty or which contravenes section 232(5) and (6) of the Corporations Law.

The Parent Entity has, on behalf of the Group, arranged insurance cover in respect of amounts which the Parent Entity may have to pay under any of the indemnities set out above.

Environmental disclosure

The operations of the Parent Entity are not subject to any particular and significant environmental regulation under any law of the Commonwealth of Australia or any of its states or territories. The Parent Entity may, however, become subject to environmental regulation in enforcing securities over land for the recovery of loans.

The Parent Entity has not incurred any liability (including for rectification costs) under any environmental legislation.

Rounding of amounts

The Parent Entity is an entity to which ASIC Class Order 98/0100 dated 10 July 1998, relating to the rounding of amounts in Directors' reports and financial reports, applies. Amounts in this report and the accompanying financial statements have been rounded to the nearest million dollars, unless indicated to the contrary.

Year 2000

The Board actively monitors Year 2000 readiness through its Audit Committee which receives regular updates from executive management. Discussion on Westpac's present readiness appears at page 71.

Political donations

Each year the Board gives consideration to making political donations. Westpac's policy is that political donations should be made on a generally even-handed basis at both the federal and state levels to major political parties with a broad cross-section of parliamentary representation. All donations are declared in accordance with the electoral laws.

During the financial year ended 30 September 1998, donations and other contributions totalling $426,150 were made to political parties as follows:

Party	Amount[1]
Australian Democrats	$ 10,000
Australian Labor Party	$168,500
Liberal Party of Australia	$181,650
National Party of Australia[2]	$ 66,000
	$426,150

1 Represents aggregate amounts at both Federal and State/Territory levels and includes contributions made to political functions and events.
2 Includes the Country Liberal Party.

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	B	A	B	A	B	A	B	A	B
J.A. Uhrig	10	9	3	3	4	1	4	2	6	5	3	–
W.B. Capp	10	10	3	3	3	3	–	–	6	5	3	1
Sir Llewellyn Edwards	10	10	3	2	3	3	–	–	6	4	3	–
J.B. Fairfax	10	10	3	3	–	–	4	4	–	–	3	2
R.P. Handley[2]	9	9	3	3	–	–	–	–	–	–	2	1
I.R.L. Harper	10	10	3	3	7	7	–	–	–	–	3	2
W.P. Hogan	10	9	3	3	–	–	4	3	3	2	3	–
R.L. Joss	10	10	3	2	–	–	–	–	–	–	3	1
H.A. Lynch[2]	9	8	3	2	4	3	–	–	–	–	2	–
E. Mahlab	10	10	3	2	–	–	4	4	3	3	3	–
D.R. Morgan[2]	9	9	3	2	–	–	–	–	–	–	2	–
J.P. Morschel	10	9	3	2	4	4	–	–	–	–	3	1
P.D. Ritchie	10	10	3	3	3	2	–	–	6	5	3	–
C.J. Stewart[2]	9	9	3	3	–	–	2	2	–	–	2	1

Column A – Indicates the number of meetings held during the period the Director was a member of the Board and/or relevant Committee.
Column B – Indicates the number of those meetings attended.
Whilst not shown above, executive Directors and many non-executive Directors who are not Committee members also attended Board Committee meetings during the year.

1 The membership of special committees comprises any two Board members.

2 Mr Handley, Ms Lynch, Dr Morgan and Mr Stewart were appointed to the Board on 12 November 1997.

Signed in accordance with a resolution of the Board of Directors.

J.A. Uhrig

J.A. Uhrig
Chairman

11 November 1998