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Transcript of podcast with ANZ Chief Risk Officer Kevin Corbally, ANZ Acting Chief Financial Officer Shane Buggle and ANZ Head of Investor Relations Jill Campbell

JILL CAMPBELL: Hi everyone. I'm Jill Campbell, the head of investor relations for ANZ. Welcome to all of you listening to today's discussion, which accompanies ANZ's release of its first half 2021 financial results. As we always do, we've released a number of materials today via the ASX. All of which are also available on the ANZ website in the Shareholder Centre. Our CEO and acting CFO present the results to the market and a slide pack accompanies that presentation. You might find it useful to refer to that slide pack after listening to this interview. The presentation which occurs at 10 am is taped and it's available for replay on our website. I'm speaking today with our Chief Risk Officer Kevin Corbally and our acting CFO Shane Buggle. Covering some areas of interest to those of you looking to delve a little deeper into several areas of the result. I'm going to start with you Shane. ANZ announced an increased dividend today. Dividends ultimately are a board decision. What kinds of factors do the management team and the Board weigh up in making those decisions?

SHANE BUGGLE: Thanks Jill. Look at the outset I think it's important to say that The Board - and indeed management - are very aware of how much shareholders value dividends. We know that last year the reduced dividend was really hard on lots of our shareholders. In this half the dividend decision required the weighing up of a few factors – our capital levels, and within that the level of capital generation which reflects how our business is travelling, and of course the level of credit provisions held. This is an important consideration given the environment we're in. We know the market values a level of predictability and sustainability in dividend flow, so we're pleased to be able to move closer to our longer term payout ratio and to fully frank the dividend. The environment though is still unpredictable. We saw another snap lockdown in WA only recently. And the world is a long way from being out of the woods. While Australia and New Zealand have come through well so far, some conservatism is warranted. I also want to say that shareholders should see the dividend announced today as a sign the Group is well placed.

JILL CAMPBELL: Well, last year, and actually a few times now ANZ has returned capital. Given that the Group is sitting at 12.5% CET1 on a proforma basis, will we do that again?

SHANE BUGGLE: Look, capital efficiency remains a key element of ANZ's strategy and you've seen the Group's focus on that over the last five years. And I think we can say we've been a good steward of capital. As you say, our CET ratios are comfortably above APRA's 'unquestionably strong' benchmark, about $7 billion dollars above it in fact. So clearly we have some flexibility to consider capital management if the capital isn't required in the business or there aren't reinvestment opportunities. However, there's still a fair bit of uncertainty across the various economies we operate in and being strongly capitalised is important. For example, we won't see the full impact of the end of JobKeeper for a few months and there are parts of the economy that are having a harder time. So we have to balance a strong capital position and the desire for capital efficiency with where we are in this cycle. And that balance is something we continue to discuss.

JILL CAMPBELL: Thanks Shane. I'm going to move to you now Kevin. ANZ released a net $491 million of provisions today, credit provisions. It's quite amazing isn't, it if you think back to this time last year? Can you walk through the thinking behind that outcome?

KEVIN CORBALLY: Sure. And just to clarify that net $491 million provision release that you refer to is comprised of a $678 million collective provision release, which is offset by a $187 million individual provision charge. And there's a number of balancing factors here which

have to be weighed up. We came into this financial year in a strong position both from a capital and provisioning perspective and we're now at 12.5% Common Equity Tier 1 ratio and we've got $5.1 billion in total provision balances, which includes $4.3 billion in collective provision balances at the end of the first half. And you may recall last year I mentioned that we had a relatively new accounting standard – referred to AASB 9 – which applies to all banks. And it required us to hold provisions for future losses, not only due to circumstances today, but also due to how we expect the economy to evolve in the future. So that's more of a forward-looking assessment and I think I referred to it as setting money aside for the future rainy day that you may or may not need. Now we put on $1.7 billion of additional provision charges between March and September last year for that rainy day. And look, essentially it hasn't rained as much as we thought it might. So through the first half of this year we've released about a third of that increase from last year. Now the improved economic outlook – noting that this is relative to what were pretty dire estimates this time last year – gives us comfort to release some of that build-up in provisions. The economy and then, by definition, many of our customers both big and small are currently appearing to be in a much better place than was anticipated at the same time last year. And we also saw some portfolio reductions in Exposure at Default during the half – largely in Institutional – as well as improved trading conditions across a number of sectors, which have resulted in an improvement in our risk ratings of both our Institutional and elements of our Commercial and Retail customer base. Nevertheless though, we thought it was prudent and appropriate to hold onto a significant amount of the build-up. Given as Shayne just mentioned a few moments ago, we're not out of the woods yet.

JILL CAMPBELL: Ok, so let's go into that last comment just a little bit more, if you could expand on it. What kinds of things would you need to see? What are you looking for that would give you more comfort to perhaps release some more provision in the future?

KEVIN CORBALLY: Sure. Look, remember we struck our provisions estimates at the end of March. There was then, and quite frankly there still are, a number of uncertainties. So for example, JobKeeper and JobSeeker had only just finished, the deferral program for mortgage and commercial customers had just finished, Brisbane had actually announced a lockdown. And looking back, the volatility in economic outlook over the last year has been quite extraordinary. I think about this time last year, and even September last year I should say, our economists thought housing prices would decline by 9% this year. Now the expectation is up by 17%. And as a management team, together with the Board, we have to shepherd through that and strike some sort of balance. And additionally, other factors like the speed of vaccine rollout, sporadic snap lockdowns and events happening offshore, all have to be considered. While things are definitely way better in Australia and New Zealand than they were this time last year, this is an extreme event and there's quite a bit yet to play out. So we want to exercise some caution notwithstanding the strong capital and provision balance that I mentioned before.

JILL CAMPBELL: Ok. So with banks like ANZ, or any of the big banks and small banks, they have what are called internal risk models that have to deal into these kinds of situations. How does a model deal into this?

KEVIN CORBALLY: In what I suppose I would call normal or relatively benign economic conditions, the models that we use to calculate our expected credit loss work well for our provision estimates. But the models were not calibrated to deal with the extreme economic movements that we've seen in the last 12 months. We moderated our economic scenario weights so there was reduced weighting to the base case, which is – our base case is somewhat at the optimistic end of consensus forecasts. And we increased the weightings to the downside with some additional provisions that we held onto to reflect the higher risk associated with our models under those volatile economic conditions. We also took a small increase in our management overlays to reflect the fact that our modelled delinquency numbers don't reflect that the substantial deferral support packages that have assisted our customers. And we re-evaluate the effectiveness of the modelled delinquency peaks every quarter and in this case we took an additional $50m increase to overlays that are held predominately for our Mortgages and Small Business books. So stepping back and thinking about where the economy is at, especially relative to last year, how many of our customers

have returned to normal payments post the payment deferrals. But also the level of volatility and uncertainty that still exists, we believe our current provision levels are prudent and appropriate and we're comfortable with the level of the release.

JILL CAMPBELL: Thank you. So most of what we've just talked about is really about what we'd call collective provision. If we talk a little bit now about individual provision because that tends to be the money you do lose. It was quite a bit lower this half and we saw this in the quarter as well than the longer term, how should we think about that?

KEVIN CORBALLY: The first step is to think about the composition of the individual provision charge, it's actually an aggregate of provisions taken for newly impaired exposures, increases in provisions that we hold for existing impaired exposures and then any write backs or recoveries that we receive as part of our workout activities. And essentially in the half, write backs and recoveries were basically in line with the last two halves and substantially offset provisions that we raised for new impaireds. Increased impaireds were a relatively small component of the provision charge for the half. There's no question this is abnormally low. For example, over the last seven or eight halves we would average around $400 million in a half. I think this reflects a few things. Importantly, it reflects the fact that our larger customers are in a much better financial position and also unquestionably I think it reflects the ongoing work on reducing our risk profile and improving the credit quality of our book - not just in our Institutional business - over the last number of years. In addition, it clearly also reflects the government support by way of various programs over the course of last year and early into this year. And also the deferral programs that the banks provided. And these last two factors provided customers I think with valuable time to navigate the first stages of the crisis.

JILL CAMPBELL: Absolutely. Thank you. Shane I'm going to go back to you now we'll talk about margins. Good margin performance in the first half, when you look through it, what were the drivers?

SHANE BUGGLE: Thanks Jill. Look it is a good margin performance, in fact this is the best margin performance in a decade. Margin was up 6 basis points in the half or 3 basis points to 160 basis points on an underlying basis. And importantly, the margin was up in each of our divisions. This outcome is in line with the outlook provided at both the Full Year 20 Result and the First Quarter Trading Update. And so over the period we've had to manage across a number of competing factors. Now the trading environment both helped and hurt. Now there's a chart in the pack which will step you through what I'm just about to talk through.

JILL CAMPBELL: Right.

SHANE BUGGLE: I recommend people have a look at that. So we saw a negative 3 basis points impact from low rates on capital and replicated deposits, net of repricing after the standard and variable cash rate change. We also saw a negative 3 basis points impact arising from holding higher liquid assets. The higher liquids meant we were able to reduce our reliance on the RBA's committed liquidity facility and so while negative for margins, it's actually a positive for returns. Asset margins improved 2 basis points and that was the outcome of better Institutional lending margins, somewhat offset by competitive pressures in home lending. There was a mix benefit primarily in liabilities and specifically we saw higher at call deposits which were up 5 per cent on average. And finally we benefited from good deposit management pricing across all business as well as lower wholesale funding costs. Together, those two items drove a 4 basis points benefit.

JILL CAMPBELL: The drag on margins that comes from, what gets called in the industry, replicating deposits, has been pretty persistent and this is for the sector, not just ANZ. You've mentioned it in your commentary that it might be lower in the next half, can you walk through why?

SHANE BUGGLE: Yes, that's a really good question. So just standing back thinking about that portfolio, the tenor of that portfolio is three to five years and so the sector has seen a

headwind arise as maturing tranches are replaced by new tranches at lower interest rates. We called out, as you said, a 3 basis point impact for the first half 21 and that's precisely where we came in. In the second half we think the impact will be more like 1 basis point and that's for a couple of reasons, the first is the impact of the older tranches rolling off relative to current investment yields is reducing, so the delta between the two is reducing. And secondly, with rates moving higher recently there's been an opportunity to invest deposit growth over the last 12 months at better yields out of the five-year swap which reduces the NIM drag. We'll update on how we're seeing FY22 at the Full Year results.

JILL CAMPBELL: Sure. The area of deposits looks like it's been a benefit and again, this is the sector, not just ANZ. Is there much more that you can do in that space?

SHANE BUGGLE: Yes, you're right. Deposit growth in the system was strong last year off the back of the high level government assistance. And the lockdowns limited people's activity as well. So we've seen our customers, and that's pretty much across the board, behaving conservatively and responsibly and building up buffers if you like. You would have to imagine sector deposit growth, given its coming off that much elevated base, will moderate in the second half. Although households will see the benefit of tax refunds and it's possible that stronger credit growth will assist businesses. Opportunities to do more repricing in deposits are reducing, although we will see the full half benefit in the second half from repricing done in the first half.

JILL CAMPBELL: Okay. If we go to costs now. So still with you Shane. Another good cost outcome, and this has become something that ANZ's built up a bit of a track record on, when you look at the results travel through this half, what do you see, how does that work?

SHANE BUGGLE: Well you're right, strong cost management has been a key element of ANZ's broader strategy since the start of financial year 16 and through that period we've delivered consistent absolute cost reductions in expenses – that's over the five-year period. So the way we think about it is to focus on continuing to reduce the running, what we call the running of the business costs so that we can increase investment in what we call our accelerated strategy, without increasing the overall cost base. And if you adjust for FX, total costs were down 1 per cent for the half after absorbing around $25 million of inflation. That savings that we generated in running the business costs, helped us absorb an increase in people costs as we responded to extra demand related to COVID, which was additional call centre staff for example. And some higher leave costs that included granting extra leave to staff as recognition for their efforts through COVID. As I mentioned, we've continued to invest through the savings we've got from the running of the business and we've invested in digital channels, process automation, optimising our property footprint, and simplifying end to end processes. Broadly, if you think about it, this is the work to be able to deliver faster, better, cheaper services to our customers over time and a better experience for our teams and staff.

JILL CAMPBELL: And just finishing up, when you think about the $8 billion cost base ambition that ANZ has, are the drivers of that – so I guess the path from here – are they any different to the way that the costs have been structured over the last five years? Or is it a case of just building on what we've already done?

SHANE BUGGLE: Yes, the last one. The premise is exactly the same – continue to work away on reducing running the business costs so we can invest. We have, as you said Jill, a really good track record on this, a real discipline in the organisation. It is now after five years, part of the DNA of the organisation.

JILL CAMPBELL: It's a thing.

SHANE BUGGLE: It's a thing. So, finding headroom to increase investment is important as this drives real benefits and not only in terms of costs, but importantly in customer experience and operational risk and reducing operational risk. The more automated processes are and the more straight through they are, the less manual intervention is required and so the less chance of an error or a delay. Our customer's expectations have

continued to evolve and we are evolving along with them. We want banking to be an easy experience given it is such an important part of our customer's lives.

JILL CAMPBELL: Absolutely. So thanks to both of you and that's the end of our session today. As I've mentioned to those of you listening, there's quite a bit of material available on our website around the results, so please make sure to have a look at that. Thank you.

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