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# Measuring performance under IFRS

## Key points

- No change to ANZ's underlying business
- Increased earnings volatility likely under IFRS, driven predominantly by:
  - Provisioning
  - Hedging
- Volatility means very specific guidance no longer possible
- No change in substance of dividend policy, form of policy will need to take into account higher IFRS driven earnings volatility
- First IFRS reporting period for ANZ Group will be six months to 31 March 2006
  - NZ GDS for 3 months to 31 December 2005 will be under IFRS
- IFRS impacts will be clearly disclosed to assist investors in understanding underlying performance

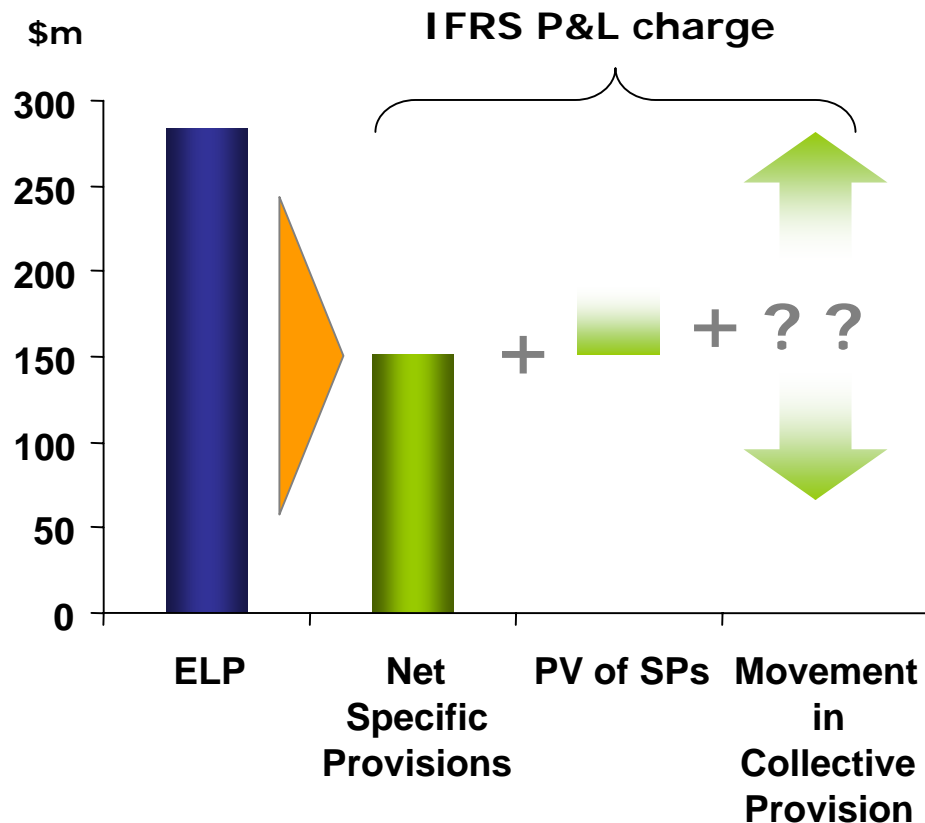
# Impact of IFRS on cash EPS

Key Areas	Cash EPS impact	Potential full year impact
Goodwill	n/a	<ul style="list-style-type: none"> <li>Goodwill no longer amortised in PAT, no impact on Cash EPS unless there is 'impairment'</li> </ul>
Fee Revenue	Small decrease	<ul style="list-style-type: none"> <li>Amortisation of fees has small impact on Cash EPS. With fees growing, this slightly lowers (lags) income in each period</li> </ul>
Hybrids	n/a	<ul style="list-style-type: none"> <li>StEPS reclassified as debt and approximately \$60m as interest expense. Impacts PAT only as already 'expensed' in Cash EPS</li> </ul>
Share Based Payments	Small decrease	<ul style="list-style-type: none"> <li>Recognition of expense for share scheme incentives increases expenses by ~ \$50m (&lt;2% Cash EPS)</li> </ul>
Financial instruments	Small decrease	<ul style="list-style-type: none"> <li>Allowing for bid/offer and credit spread is immaterial</li> </ul>
Special Purpose Vehicles	Nil	<ul style="list-style-type: none"> <li>Impact of recognition of SPV's for securitisation expected to be immaterial</li> </ul>
Hedging	"nil" (volatility)	<ul style="list-style-type: none"> <li>Impact uncertain – 'ineffectiveness' of economic hedging disclosed separately to allow this to be backed out of Cash EPS</li> </ul>
Post Employment Benefits	n/a	<ul style="list-style-type: none"> <li>Movements in defined benefit scheme likely to be booked through Retained Earnings</li> </ul>
Provisioning	+/-	<ul style="list-style-type: none"> <li>Specific provisions and movements in Collective Provision charged direct to P&amp;L driving increased earnings volatility</li> </ul>

# Credit Provisioning greatest area of uncertainty

## Significant changes to credit loss provisioning methodology

Based on 1H05



- ELP will be replaced by a charge for:
  - Movements in Specific Provisions (SP),
  - Plus/minus a charge for movements in the Collective Provisions
- SP's determined individually for large loans and on portfolio basis for 'retail' loans
- SP's reflect the loan carrying amount less PV of expected future cash flows.
- All loans not specifically provided for are collectively assessed
- Collective Provisions replaces current general provision, however expected to be smaller on transition
- Collective Provision function of change in:
  - Portfolio size
  - Portfolio mix
  - Risk & cycle outlook

# Implementation of IFRS and Basel II in Australia

- IFRS and Basel 2 are international standards, adopted by countries who wish to further integrate their financial systems into the global market
- Adoption of 'amended' global rules could result in competitive disadvantage for Australian banks – on some issues, there continues to be global diversity rather than global consistency
- Potential adverse outcomes if capital rules vary from those applying to competitors
- Less profitable banks could be encouraged to take greater risks
- Regulators can change capital ratios in response to specific conditions (eg, country economics, bank specific conditions) – this enables the rules for capital to be globally consistent, while enabling the local regulator to respond to local concerns in setting capital levels

# Provisioning post IFRS

IFRS Component	Current Equivalent	Balance Sheet Provision	Profit and Loss Impact
Individual provisions	Specific Provision	1	$\Delta 1$ = New provisions ( <i>including those provided for and written off in the same period</i> ) <b>add</b> increases in existing provisions <b>less</b> write-backs & recoveries
Collective Provisions - long-term historic performance - economic cycle adjustment - model risk and scenario modelling adjustments	} ELP less specific provisions	2	$\Delta 2$ = Current Period Collective Provision <b>less</b> Prior Period Collective Provision
<b>TOTAL</b>		<b>1+2</b>	<b><math>\Delta 1 + \Delta 2</math></b>

# Comparison to ELP

	ELP	IFRS
<b>Losses included</b>	<ul style="list-style-type: none"> <li>Average one year loss expected to be incurred if the same loan portfolio was held over an economic cycle</li> </ul>	<ul style="list-style-type: none"> <li>Losses inherent within the Group's existing loan portfolio including:               <ul style="list-style-type: none"> <li>specifically identified losses on individually significant loans and on a portfolio basis</li> <li>presently unidentified impaired loans, provision collectively assessed</li> </ul> </li> <li>Collectively assessed losses are based on long term historic portfolio performance adjusted to account for:               <ul style="list-style-type: none"> <li>current market conditions</li> <li>model risk &amp; scenario modelling</li> </ul> </li> </ul>
<b>Discount Rate</b>	<ul style="list-style-type: none"> <li>Internal funding rate</li> </ul>	<ul style="list-style-type: none"> <li>Original Effective Interest Rate (OEIR)</li> </ul>
<b>Credit provision on undrawn commitments</b>	<ul style="list-style-type: none"> <li>Includes average one year loss on expected drawdowns if the same portfolio was held over an economic cycle</li> </ul>	<ul style="list-style-type: none"> <li>Includes loss on expected drawdowns over the remaining life of the facility</li> </ul>

# Determining the Collective Provision

- Collective Provision held for presently unidentified impaired assets
- Period between when event causing impairment occurs, and when impairment identified by lender, is referred to as “emergence period”
- Emergence periods will vary according to the type of loan, and are typically around 18 months
- Methodology for calculating Collective Provision considers all credit exposures for which no SP has been made
- Collective evaluation groups loans according to similar characteristics, such as credit grade, industry, geography
- Collective Provision represents an interim step, made prior to identification of loss on individual asset
- Collective Provision is calculated based on historic loss experience of the portfolio, adjusted for current market conditions (economic cycle adjustments), model risk and scenario modelling
- Movements in Collective Provision will be directionally consistent with leading indicators of credit cycle

# Collective Provision treatment in balance sheet

- Excludes provisions for identified impairment - these are specific provisions, and assessed either on an individual or a portfolio basis.
- Basel: a general loan loss reserve, held against presently unidentified losses is eligible for inclusion in Tier 2
- FSA: general/Collective Provisions that a company holds in reserve against losses that have not yet been identified eligible for inclusion in Tier 2
- APRA: draft paper proposed that Collective Provision be ineligible for inclusion in Tier 2; and that a un-distributable reserve, equivalent to the current required minimum general provision, be created from Tier 1 retained earnings to offset
- Constructive dialogue being held with APRA

# Net interest margins under IFRS

Reported net interest margin (NIM) is likely to increase slightly under IFRS

$$\begin{aligned} \text{IFRS NIM} &\longrightarrow \\ &= \\ &\text{Existing NIM} \\ &+ \\ &\text{Amortised fee income} \\ &+ \\ &\text{Impaired assets unwind} \\ &- \\ &\text{StEPS distribution reported as interest expense} \\ &+ \\ &\text{Impact of including Bills in interest earning assets} \end{aligned}$$

$$\frac{\text{Interest earned} - i \text{ paid} + \text{yield} + \text{unwind} - \text{StEPS}}{\text{AGAAP IEA} + \text{bills}}$$

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