“It turns out the banks are the cookie jar of the nation – and we’re bloody lucky we have them.”

Kate Howitt – Portfolio Manager Fidelity International

“This is a time where cooperation between the private and public sectors is key... The banking sector has really stepped up to demonstrate its commitment to Team Australia.”

Senator Jane Hume – Assistant Minister for Superannuation, Financial Services and Financial Technology

<table>
<thead>
<tr>
<th>Growth</th>
<th>Efficiency is critical</th>
<th>Cash profit declined by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income declined by 3%</td>
<td>Total expenses increased by 14.2%</td>
<td>42.6%</td>
</tr>
</tbody>
</table>

Credit risk increasing significantly `(90DPD + GIA) / GLA` increased by 8bps

Lending growth has slowed `Total average interest earning asset growth` 2.9%

‘Unquestionably strong’ capital into the crisis `Average CET1 above` 10.5%

Source: Compared with 1H19.
Major banks: 1H 2020 results

The COVID-19 pandemic has brought the global economy to a near standstill with the International Monetary Fund (IMF) calling it ‘the worst economic downturn since the Great Depression.’ It has caused unprecedented humanitarian, economic and health crises across the world.

In the US, more than 30 million people have registered for unemployment benefits with predictions for 50 million by the end of July this year.

China’s economy plummeted 6.8% in the first quarter – the first such drop since China began reporting its quarterly GDP numbers in 1992.

The IMF’s latest World Economic Outlook projects global growth in 2020 to fall to -3% with the Australian economy contracting by 6.7%.

Despite the record $340bn fiscal and monetary stimulus, Australian unemployment is expected to approximately double from March’s 5.2%.

As Prime Minister, Scott Morrison, recently noted: “The hit the Australian economy is taking is the biggest we’ve seen since the Great Depression... The GFC (Global Financial Crisis) was an entrée compared to what this is. This is at a whole other level.”

The good news is that the Australian banking sector entered the current crisis in a relatively strong funding and capital position. The RBA has supported the financial system with rapid liquidity support, and fortunately APRA has also given the banks some breathing space with regard to regulatory capital reforms.

It called on banks to use their capital buffers if necessary, allowing them to fall below the unquestionably strong target of 10.5%, well above the CET1 regulatory minimum of 8%.

In terms of growth, the underlying outlook remains challenged and margins will continue to be under pressure and contract as they are impacted further through the coronavirus pandemic and the economic recession.

Given the uncertain future, many households and businesses are also holding back their spending and investment.

This growing risk to earnings, coupled with provisioning has reduced dividend payouts. Since the start of this year the majors have collectively lost approximately $116bn (~31%) in market capitalisation.
Shift to digital

When it comes to efficiency the structural challenges to long term profitability coupled with the response to the health crisis has accelerated banks shift to digital channels. Long term transformation programs have been delivered in extremely short turnarounds.

As NAB CEO Ross McEwan noted in his address at the end of March to the AFR/Deloitte Banking & Wealth Summit, the bank was able to launch its mortgage lending online in three days as opposed to the 12 months it had been scheduled to take pre-crisis.

In this vein, the sector has delivered remote working, remote call centres, and a proactive approach to protecting their workforces.6

The banks have also taken the opportunity to redeem their reputations by offering their customers loan repayment deferrals, concessional terms for SMEs and residential mortgage customers with alacrity and transparency.

The uncertainty around the scale and depth of the economic disruption caused by the crisis remains, but by acting quickly to minimise the short term impact “this is a moment that the banks have redeemed themselves”, as Professor Ian Harper, Board member Reserve Bank of Australia (RBA) said, adding: “As we come out on the ‘other’ side they will have disrupted a lot of arrangements which were impeding progress.”

The domestic banking sector mirrors the state of the Australian economy. Due to the global spread of COVID-19, the sector will also face an extended period of low economic and credit growth.

Deloitte Access Economics puts the likely loss of wages and profits in the four months from the start of April to the end of July at almost $60bn.

With declining NIMs, rising impairments for individual and corporate loans, a sharp deterioration in consumer and business confidence and increased operational costs, financial stability must take priority. Competition will return in time.

Given their strong balance sheets, the majors are extending significant support to Australian businesses and households. However, they cannot be expected to save the entire economy. Banks have to make sure that they allocate their finite resources in the right direction.

It is not surprising that the aggregate 1H FY20 cash profit of the major banks declined by $6.2bn to $8.3bn. (43% down vs 1H 2019) and the bottom line results were impacted by $3.6bn of large, notable one-off items.

Even after stripping out these items, underlying cash profit from continuing operations declined by 24.4% highlighting the very challenging outlook for the sector.
The COVID-19 pandemic has brought extraordinary challenges for the Australian banking sector. However, the sector is well positioned to withstand the structural economic shock compared to the GFC and it can leverage this crisis to accelerate its digital transformation and simplification for a post-COVID-19 world.

**Headwinds**

**Unprecedented economic backdrop could significantly increase the arrears**

The Australian economy is likely to plunge into recession for the first time in nearly three decades. The unemployment rate is expected to reach double digits. The challenging backdrop is likely to result in widespread bankruptcies and weakened property prices leading to significant increases in loan and mortgage arrears.

**High level of household debt**

Consumer spending accounts for almost two-thirds of Australia’s economic activity and given Australian household debt is close to 200% of income, consumers are likely to be cautious even after the restrictions are lifted. Economic disruption caused by prolonged shut down of the economy, travel and migration restrictions are all likely to bring long term change to consumers.

**Non-Financial Risks**

The idea of the ‘triple bottom line’ – profit, people and the planet has become mainstream. Boards need to effectively scenario plan for black swan events. While boards and management may have had pandemic plans, very few thought it likely, and no-one knew of the devastating economic effect it would have. There was no COVID-19 ‘playbook’ and there will be lessons learned by all for the future.

**Tailwinds**

**Structural changes to the cost structure**

This crisis has provided a window of opportunity for the banks to accelerate their plans for long term structural changes to their cost base. Improving productivity will be critical to creating a new normal and doing better. The objective of delivering a simpler and better banking experience for customers has never been so achievable. Long term transformation programs are being delivered in a matter of weeks and months.

**Redemption opportunity**

By proactively extending support to households, small businesses and corporates, Australian banks are enhancing their reputation by facilitating the transmission of government, regulatory and central bank support. By cushioning the country through the crisis, the banks have the opportunity to bridge the ‘trust gap’, and enable the sector to proactively manage the transition, minimising the negative impact and ensuring the optimum supply of capital to support the growth of the economy on the upside.

**Growth and innovation the hallmarks for the future**

With renewed investment and reforms to increase digitisation, business model updates and reinvention, the banks have the opportunity to innovate new products, new services and new ways of doing things. Whatever the choices made for recovery and growth, the financial services sector will be critical in delivering growth and innovation as the hallmarks for our future.
### What is profit?

Statutory Profit. Cash Profit. Cash Profit from Continuing Operations. Underlying Profit. The banks report a number of different profit results.

<table>
<thead>
<tr>
<th></th>
<th>ANZ</th>
<th>CBA</th>
<th>NAB</th>
<th>WBC</th>
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<td>Cash Net Profit after Tax from continuing operations excluding 'one-offs' and notable items (estimate)</td>
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<td>4.70</td>
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<td>Core earnings before tax (excluding large notable items and impairment charges)</td>
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<td>7.22</td>
<td>4.70</td>
<td>5.61</td>
<td>22.63</td>
</tr>
</tbody>
</table>

Source: 1H 2020 Results and Investor presentations for ANZ, CBA, NAB and Westpac and Deloitte analysis.
Growth

“For the Commonwealth Bank to be successful, we need Australia to be successful. We have complete alignment with policy makers, regulators and government... The fate of the banks will ultimately rest on the speed of the economic recovery. If there are too many businesses permanently damaged, that makes recovery that much harder, which will flow right into the financial system. None of us have seen anything like this in our lifetimes.” Matt Comyn – CEO, CBA

Major banks: 1H 2020 results

<table>
<thead>
<tr>
<th>Bank</th>
<th>Cash Profit from continuing operations (AUD Billions)</th>
<th>Cash ROE %</th>
<th>NIM %</th>
<th>Average Interest Earning Assets (AUD Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANZ</td>
<td>1.52</td>
<td>2.94</td>
<td>1.69</td>
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<td>CBA</td>
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<td>NAB</td>
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<td>Westpac</td>
<td>1.44</td>
<td>5.30</td>
<td>1.78</td>
<td>875</td>
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</table>

Note: Banks’ comparative positioning here is based on approximation. Cash Profit and Operating Costs have been stated on a continuing operations basis including large notable items. CBA’s first half ended 31 December 2019 and therefore no provision was made for the impact of COVID-19.

Indicates increase/decrease in numbers with respect to the previous corresponding period.
No arrow indicates no change from the previous corresponding period.

Source: 1H 2020 Results and Investor presentations for ANZ, CBA, NAB and Westpac and Deloitte analysis.

Cash profit and total operating income

The Commonwealth Bank of Australia’s (CBA) 1H 2020 results (for the half ending on 31 Dec 2019) were declared in February this year. Hence, the results were not significantly impacted by the widespread outbreak of COVID-19 and related provisions.

The CBA, however, recorded a fall of 4.3% in its cash profit for 1H 2020 as a result of higher operating expenses (up 2.6% vs 1H 2019), which included $83m for bushfire related claims and higher loan impairment expenses of $649m (up 12.5% vs 1H 2019), which in turn included $100m provisions for drought and bushfire.

Its topline income was flat (vs 1H 2019), with the increase in net interest income of 1.7% offset by a 4.6% reduction in non-interest income as a result of bushfire related claims, the removal and repricing of certain fees in the wealth management business and realised losses on the hedge of NZ earnings.

The CBA’s home and business lending grew by 4% and 3% respectively with its home loan volumes growing faster than system. This was offset by a reduction in institutional lending (down 9% vs 1H 2019).

The ANZ’s cash profit from continuing operations was down 60% to $1.4bn. This was due mainly to significant COVID-19 related impairment provisions of $1bn and the $815m write-off of investments in its Asian businesses. It was also as a result of a decline in operating income and increase in operating expenses. ANZ’s net interest income decreased by 1.1% despite a 5.6% increase in interest earning assets. This was primarily due to a decrease of 11bps in NIM to 1.69%. The increase in ANZ’s interest earning assets was driven by a significant increase in its non-lending interest earning assets (cash and other liquid assets), which comparatively earns lower interest.

This was partially offset by its growth in its business lending portfolio. The decline in operating income was also partially offset by an increase in Trading Income (14.5%). When large notable items and the credit impairment charge is excluded, ANZ’s core earnings before tax declined by 3.1% compared with 1H19.
Cushioning the country through the crisis | Australian major banks half year results FY20

The National Australia Bank’s (NAB) cash earnings declined by 51.4% compared with 1H19 as a result of a significant increase in impairment charges of $807m relating to COVID-19. NAB’s total operating income declined primarily due to lower ‘Other Operating Income’. This included a decrease of 56% or $420m in trading income as a result of valuation losses in its high quality liquids portfolio.

Net interest income increased by 1.9% with a 2.5% increase in interest earning assets, which partially offset the decline in income. NAB’s core earnings before tax declined by 9% compared with 1H19.

Westpac’s cash earnings declined by 70% to $993m compared with 1H19 as a result of a significant increase in operating expenses (22.2%) and impairment charges of $2.2bn. Westpac’s total operating income increased by 2.4% to $10.3bn as a result of a 3.3% increase in net interest income.

The growth in Westpac’s net interest income was supported by a 2.3% increase in average interest earning assets as well as 1bps increase in NIM. Westpac’s Return on Equity (ROE) declined significantly to 2.94% from 10.43% (1H19).

Divisional performance
All the banks split their divisional results slightly differently. CBA’s retail banking services division increased by 4.6%. After excluding the COVID-19 impairment charge, ANZ’s Australia retail institutional and New Zealand divisions all declined significantly. NAB had a significant increase in its consumer banking and New Zealand divisions of 26.4% and 6.4% respectively (excluding COVID-19 impairment charge). NAB’s institutional division declined owing to valuation losses from its liquidity portfolio.

Westpac’s consumer bank dropped by 13.8% and its business bank and institutional bank fell by 51.2% and 67.8% respectively. Within Westpac’s institutional division, total customer revenue declined by 8% which was partially offset by an increase in trading revenue.

In response to the government’s approach ‘to protect lives and livelihoods’, the majors have assumed a front line role, cushioning the country through the crisis. They have amplified the impact of fiscal and monetary policies by proactively extending support to households, small businesses and corporates in the form of loan deferrals and reducing repayments.

However, following the Hayne Royal Commission from last year, 2020 will be another testing year for the domestic banking industry.

Australia has been so far successful in controlling the spread of COVID-19, but the prolonged lockdown, rising unemployment, lower for longer interest rates, falling business and consumer confidence, widespread bankruptcies and high household debt, are likely to significantly impact the banks’ top-line growth and cause structural challenges to longer-term profitability of the sector.

Although the length and depth of the economic contraction is difficult to predict, the combination of anaemic revenue growth due to the loss of Australia’s economic growth momentum and the lower for longer interest rate environment, points to a very challenging outlook for the banking sector.

Key questions
Questions the Executive should consider include:

1. How do we balance the economic downturn, regulatory compliance with lending standards, and the need to continue funding the economy and grow the business?
2. Are we focused on the right activities to drive strong customer relationships and growth?
3. Do we effectively manage customer transition points e.g. life events, contract expiry etc.?
4. Do the promises we are making to our customers align with their expectations and our capacity to deliver?
5. Are we effectively using our analytic tools and are they the right ones?
6. Can we improve our understanding of the drivers of customer pressure, churn and switching?
7. Do we tailor our sales and marketing programs to specific customer segments?
8. Have we adopted strategic pricing programs?
9. What platforms are we using to meet customers’ needs and should we refresh our alliances to continuously improve our products and services delivered through these platform?
10. Are we allocating investment to increase digitisation and making business model updates to enable innovation in new products, new services and new ways of doing things?
Efficiency

“Once this is over, will we see, a return to the level of the kind of personal, on-the-spot service and branch networks we’ve been used to? Will I need all the buildings I have, given some of my work colleagues can do their work from home in the future?

Big banks like NAB have adapted and responded to the crisis quite quickly – 75% of NAB’s 34,000 employees are now working from home and 75% of NAB’s contact centre employees are working from home. NAB activated its mortgage advice via video conference in three days. Before the crisis, the bank estimated it would take around 12 months to activate.” Ross McEwan – CEO, NAB

Major banks: 1H 2020 results

The new operating environment for the banks post the Hayne Royal Commission has resulted in a permanent increase in the cost of doing business. As a result of COVID-19, cost-cutting ambitions of the major banks are likely to be hampered because of the prolonged shut down and physical distancing measures.

The CBA headline costs rose by 2.6% while its income was flat compared with 1H 2019, resulting in negative jaws. CBA’s cost to income (CTI) ratio increased slightly due mostly to lower income.

NAB reported a significant increase in CTI to 62.4% mostly due to large remediation and software charges of around $1.2bn. Excluding the effect of this NAB’s CTI increased by 270bps to 46.7%. ANZ had an increase of 890bps to 53.7%, which includes large notable items on a continuing operations basis.

CBA, NAB, ANZ and Westpac had slight increases in underlying operating expenses compared to 1H19 of 3.8%, 1.6%, 2.7% and 4.3% respectively.

ANZ’s spot Full Time Equivalent (FTE) staff numbers increased slightly alongside a 4% increase in its personnel expenses. Technology expenses were up by 9.8%. Other expenses also increased due to higher investment spend.

The CBA’s personnel and technology expenses rose by 4% and 9.3% respectively compared with 1H19, which was partially offset by reductions in occupancy expenses due to the closure of branches and other expenses. The CBA’s FTE numbers declined slightly compared with 1H19.

NAB’s FTE numbers increased by 4.3% compared with 1H19, which was reflected in its increase of personnel expenses of 3.7%. NAB’s total underlying expenses increased by 1.55%.

Westpac’s total operating expenses increased by 22.2% as compared with 1H19. The bank noted an underlying increase of 14% in its technology expenses mainly due to capitalised software write-downs and amortisation of software assets. The underlying staff expenses decreased by 1% because of a 3% decline in average FTEs. Other expenses have increased significantly due to a $1.06bn provision relating to AUSTRAC.

Collectively the major banks’ total operating expenses were up significantly to $21.5bn, representing a 14.2% increase over the last year because of the increase in regulatory compliance and remediation costs.

Note: Banks’ comparative positioning here is based on approximation. Cash Profit and Operating Costs have been stated on a continuing operations basis including large notable items. CBA’s first half ended 31 December 2019 and therefore no provision was made for the impact of COVID-19.

Source: 1H 2020 Results and Investor presentations for ANZ, CBA, NAB and Westpac and Deloitte analysis.
Key questions

Questions COOs, CIOs, CFOs and business units should be asking include:

1. Are we harnessing the transformational power of digital technologies to streamline our cost structures?
2. Can we increase cross-business unit and cross-enterprise collaboration?
3. Can we increase business agility and flexibility?
4. Do we have the right skills and capability to deliver our strategy?
5. Can we improve our training processes to emphasise customer experience and culture?
6. Can we improve our processes for managing systems operation, maintenance and change?
7. Can we further rationalise our IT application portfolio?
8. Can we consolidate or re-architect data stores?
9. Can we improve IT performance management methods and tools?
10. Can we establish product, service and process innovation as core competencies?
11. Are there options to buy or rent capabilities as well as build?

Large notable items and discontinued operations

NAB’s large notable items included charges related to a capitalised software policy change ($1.05bn) and customer-related remediation ($418m). This was partially offset by a $439m income tax gain.

CBA’s underlying profit was not as impacted by large notable items when compared with 1H19 (notable items declined by $50m compared with 1H19). This consisted of customer remediation costs ($30m) and risk & compliance program costs ($196m).

The majority of ANZ’s large notable items related to the impairment of its Asian associates, Ambank and PT Panin, which cost $815m. A further $91m in customer remediation costs were also recognised in HY20.

For this half, Westpac’s large notable items were $1.29bn, which included $1.03bn relating to AUSTRAC and $258m for customer refunds, payments, associated costs and litigation.

In this era of anaemic revenue growth, ‘zero bound’ interest rate environment offsets are hard to find. Top-line growth will be challenging in the short to medium term, and strategic investments in transformational technologies will play an important role in capturing the opportunities post the economic recovery and a rebound in consumer and business confidence.
Quality & Risk

“The world is going through a once in a life-time health and economic crisis. While impairment provisions have begun to increase, the extent of additional charges in subsequent periods will depend on the severity and duration of the decline in economic activity and the size and effectiveness of stimulus measures.” Peter King – CEO, Westpac

Major banks: 1H 2020 results

<table>
<thead>
<tr>
<th>KPI</th>
<th>ANZ</th>
<th>CBA</th>
<th>NAB</th>
<th>Westpac</th>
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</thead>
<tbody>
<tr>
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<td>10.81</td>
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<td>NSFR</td>
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<tr>
<td>Cash ROE %</td>
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<td>NIM %</td>
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<tr>
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<td>Impairment expense to GLA (annualised) %</td>
<td>5.7%</td>
<td>5.7%</td>
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<td>Collective Provision /CRWA %</td>
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<tr>
<td>Credit RWA (AUD Billions)</td>
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<tr>
<td>Impairment expense to GLA (annualised) %</td>
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<td>13bps</td>
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<td>Operating Costs (AUD Billions)</td>
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<td>FTEs (spot)</td>
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<td>Operating Costs (AUD Billions)</td>
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<tr>
<td>FTEs (spot)</td>
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<td>Total RWA (AUD Billions)</td>
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<td>Credit RWA (AUD Billions)</td>
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<td>Impairment expense to GLA (annualised) %</td>
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<td>Collective Provision /CRWA %</td>
<td>0.0%</td>
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The outlook for the Australian economy and by extension the domestic banking sector is quite uncertain. As Ross McEwan said (28 April) “…You and I just don’t know. There is no playbook here. We haven’t seen this before. and that’s what ‘unprecedented’ means.”

Jobkeeper payments (approx 6 million of Australia’s 13 million workforce are expected to receive this payment) and loan deferrals (residential mortgages and SME loans) which come to an end in September, are all temporary measures, along with rent deferrals and closed state borders etc.

Ahead the concerns are around, ‘What happens to credit, hardship, and defaults when these temporary measures are withdrawn? To what extent will they be offset by easing restrictions? And to what extent will any behavioural changes (e.g. move to debit cards from cash for payments) be lasting?

The length and depth of the economic impact from COVID-19 is where the ‘unprecedented’ uncertainty lies. Australia along with the developed world, will face one of the worst economic downturns in history.

The Grattan Institute, along with Deloitte Access Economics’ estimate, Australia’s unemployment rate could rise to between 10-15%. The headwinds the banks are facing include:

- Significant fall in consumer confidence
- All-time low business confidence
- Potentially double-digit unemployment
- Significant economic contraction for the first time in nearly three decades
- High household debt to GDP – second highest amongst the G20 nations
- Comparatively lower housing demand because of reduced inward migration.
Asset quality is a substantial earnings risk for the majors for FY20 and beyond. All the majors, (except CBA) have experienced increased asset impairments for 1H 2020.

The NAB’s total impairment charge was $1.16bn, 38 basis points of gross loans and acceptances (GLA), which included a provision of $807m for COVID-19. Whereas ANZ’s impairment charge was $1.67bn (53 basis points of GLA), and Westpac reported $2.2bn (62 basis points of GLA), which included a $1.6bn provision for COVID-19.

However, the Australian banking sector is relatively better positioned than when it went into the 2008/09 GFC to withstand the structural economic shock from COVID-19.

The RBA in its latest Financial Stability Review, noted: “Stress tests of Australian banks show they have sufficient capital to withstand quite severe downturns. ‘Top-down’ stress tests indicate that even if there is no economic recovery in the second half of 2020 (so that asset quality issues grow) banks will remain above their minimum capital ratios, although they may need to make use of their capital conservation buffer.”

**Key questions**

Questions CROs and business units should be asking include:

1. Have we reassessed the organisation’s risk tolerance in light of the COVID-19 crisis?
2. Have we and are we continuing to effectively stress test our risk management processes?
3. Have we a clear cross-enterprise customer view of risk and have we effectively communicated it?
4. Have we effectively added risk assessment into our new products and services?
5. Is our data collection, aggregation, use and reporting robust?
6. Is operational risk effectively incorporated into our key controls enabling us to rapidly and effectively respond to shifting business needs, risk exposures, regulatory change and community expectations?
7. Are we continuing to monitor and supervise third parties to mitigate risk, particularly with a view to the changed supply chains?
8. Do we effectively measure our performance in meeting the promises we make to our customers?
9. Do we have the right capabilities in our risk and compliance teams?
Recasting Operational Risk in COVID-19

The COVID-19 pandemic is no Black Swan event, rather it is what Michele Wucker describes as a Grey Rhino – highly obvious and highly probable, but still neglected. And as such it has meant that almost every company was unprepared and is now scrambling to manage the financial and operational capacity shocks that directly challenge their existing risk, control, and defence models.

As we navigate through this respond phase – perhaps the most disruptive period of the crisis – we need to be prepared to be effective in our immediate environments and strengthen our resilience into the future.

The following seven themes require recasting as key risks to the financial services industry emerge as we respond to COVID-19:

1. Conduct

Effectively balancing obligations between customers, shareholders and other stakeholders will require leaders to make complex and sometimes difficult decisions for instance the complexities that are arising in areas such as managing between principles for responsible lending and assessing eligibility for assistance.

• As such, organisations need to have clear, defined, defendable and robust processes for managing an increasing number of potentially sensitive customer requests.

• Managing hardship obligations and dealing with default will be of particular focus, especially where credit extensions are provided and related parties involved such as guarantors and joint accounts.

2. Technology, cyber and data privacy

The sudden imperative to work virtually, where the industry as a whole pivoted their entire workforces in record time to access the organisations systems and information remotely, has exposed the industry to heightened operational risks.

• This shift in working rhythm has meant a critical dependency on effective security, identity management, and system availability controls.

• The Deloitte Australia Cyber Intelligence Centre (CIC), along with its network of 33 CICs across the world, has observed a material uptick in malicious attempts by third parties to penetrate client systems and access sensitive information.

• This includes phishing and ransomware attacks, remote working security risks and supply chain attacks, as well as delays in detecting and responding to cyber-attacks and an influx of cyber criminals.
3. Staff resilience
In this rapidly changing environment, a wave of ancillary health risks is coming to the fore. This means that organisations are obliged to ensure their staff members are appropriately supported and empowered in their resilience.

- Many staff members will be experiencing new levels and forms of stress and uncertainty, driven by health, financial or the social consequences of distancing due to COVID-19.
- Leaders need to consider both what they need to do and evaluate whether they are doing enough to help their teams adapt and respond.
- Having a proper way to educate and support staff members who are struggling to make the right decisions in the current unprecedented environment, is key to ensuring the organisation pivots effectively.

4. Staff re-allocation
With the rapid shift in priorities due to COVID-19, organisations are increasingly moving ‘non-essential’ staff into essential customer services. As such, there is a need to rapidly upskill staff members to ensure they understand their new roles, responsibilities and obligations.

- In tandem, organisations need to react quickly to on-board these staff members into their new roles to ensure continuity of essential services, including provisioning appropriate system access, monitoring compliance with processes, and documenting efficient and effective procedures for business critical service decisions such as hardship decisions.
- The focus needs to be on the processes and controls that must now be relied upon to manage these new ways of working.

5. Fraud
In previous times of hardship, such as during the Global Financial Crisis, there were marked increases in fraud and financial crime. With the additional banking and government relief measures being made available to businesses and individuals impacted by COVID-19, we may see similar trends occur.

- Although there may not yet be a clear estimate over how severe the fraud risk will be in this unprecedented environment, it is a continually emerging risk which needs to be adequately monitored over the coming period.
- Organisations will need to ensure their controls and assurance activities across hardship and relief determination processes are robust and effective.

6. Collateral
With the introduction of payment deferral options provided to customers, there are heightened concerns over loan guarantees and the collateral underpinning the assets. These risks are further exacerbated due to:

- Concerns over significant asset revaluations which could potentially lead to negative equity.
- Additional restrictions on the ability of organisations to access collateral, such as family homes, particularly given the sensitivities around vulnerable customers.

7. Implementation Risk
Significant and uncharacteristic changes to policies, such as automatic extensions of credit are happening rapidly in response to changing needs.

- As such, organisations need to ensure that their processes and systems can adapt and apply the changes to both customers and products in an accurate, consistent and timely manner.

While these risks will continue to evolve, organisations need to focus on the key controls they will rely on to rapidly and effectively respond to shifting business needs, risk exposures and community expectations.
Cushioning the country through the crisis | Australian major banks half year results FY20

For the past decade Australia’s big four banks have managed to build up their capital reserves to meet APRA’s ‘unquestionably strong’ CET1 benchmark of 10.5%, over and above the minimum regulatory requirement. Subsequently APRA has advised Authorised Deposit-taking Institutions (ADIs) to use that buffer and continue to finance the economy.

APRA’s letter\(^{19}\), addressed to all ADIs and insurers, recommends conserving capital through deferring dividends and conducting periodical updated stress tests. This advice has been taken on board by both ANZ and NAB, with ANZ deferring its interim dividend and NAB reducing its interim dividend and announcing its intention to raise capital.

With these capital management initiatives undertaken, in addition to their already robust capital standing, the banks are well prepared to cushion the impact of COVID-19. Excluding CBA which released its half year result earlier in the year, all banks’ CET1 ratios have declined.

This is mainly due to impacts brought by credit impairment charges and in the case of Westpac the significant Austrac provision.

In addition to APRA’s guidance on capital management, both APRA\(^{20}\) and RBNZ\(^{21}\) have postponed their regulatory reforms by 12 months.

While APRA’s postponement does not impact the capital holding required, the postponement by RBNZ is expected to provide more ‘headroom’ for the banks to lend.

Total Risk Weighted Assets (RWA) have increased across the four banks with the biggest dollar value increase coming from credit RWA and operational risk. ANZ showed an increase relating to traded market risk and IRRBB owing to recent market volatility.

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**Capital & Funding**

“APRA has been pursuing a program to build up the financial strength of the system for many years... APRA’s objective in building up this capital strength has been to ensure it is available to be drawn upon if needed in times such as this. As a result, the Australian banking system is well capitalised by both historical and international standards.” Wayne Byres – APRA Chair\(^{18}\)

**Major banks: 1H 2020 results**

Note: Banks’ comparative positioning here is based on approximation. Cash Profit and Operating Costs have been stated on a continuing operations basis including large notable items. CBA’s first half ended 31 December 2019 and therefore no provision was made for the impact of COVID-19.

† Indicates increase/decrease in numbers with respect to the previous corresponding period. No arrow indicates no change from the previous corresponding period.

Source: 1H 2020 Results and Investor presentations for ANZ, CBA, NAB and Westpac and Deloitte analysis.

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Note: Banks’ comparative positioning here is based on approximation. Cash Profit and Operating Costs have been stated on a continuing operations basis including large notable items. CBA’s first half ended 31 December 2019 and therefore no provision was made for the impact of COVID-19.

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Source: 1H 2020 Results and Investor presentations for ANZ, CBA, NAB and Westpac and Deloitte analysis.
Funding

The outbreak of COVID-19 in March caused short term funding markets to dislocate. Fortunately the RBA was swift to fill the void and ensure funding markets were supported. As a result, balances with the RBA (Exchange Settlement Accounts) spiked and as banks had no need to borrow from each other short term, the actual overnight cash rate fell below the RBA’s target of 25 bps.

The RBA has deemed it appropriate to increase high quality liquid assets (HQLA) holdings from 25% to 30%, increasing by a percentage point each year starting 1 January 2020 to 2024\(^{22}\). This will consequently decrease the need for, and therefore amount of, the Committed Liquidity Facility (CLF), which is reflected in the decline of the CLF proportional to total LCR liquid assets across all four banks.

During this difficult period, APRA expressed its support of the RBA’s Term Funding Facility (TFF)\(^{23}\), which provides ADIs with access to three-year funding at a low interest rate. The regulator announced that the Initial and Additional Allowance of the TFF could be included in reporting the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) starting 30 March 2020 and 16 April 2020 respectively.

The reported LCR has not reflected much impact on the expected boost of the LCR numerator. All banks are comfortably meeting both liquidity targets of LCR and NSFR, and even showing an increase in both.

Across all four banks total funding has increased while maintaining a proportion of the customer deposit average of about 60% in total funding.

With the current cash rate at an all time low in both Australia and New Zealand, it is difficult not to question the future of net interest margin. So far it has not shown a notable reduction except for ANZ, which announced an 11bps reduction in the past year.

Key questions

Questions CFOs and business units should be asking include:

1. Do we understand the impact that regulatory changes in provisioning will have on our business strategy?
2. Have we communicated this to business units?
3. Do we understand how sensitive profitability is to changes in funding costs, interest rates and competitive pressures on asset re-pricing?
4. Have we assessed the impact of proposed changes to RWA’s on our product portfolio?
5. Do we have a broad diversification of funding sources and should we consider refreshing of our deposit strategy in light of the current environment?
Building for recovery is an imperative – as a country and as businesses, we can make choices to build a better future. A return to normal should not be our medium term objective; doing better must be our ambition. In this task of recovery and building a better future, the financial sector will be the catalyst. In this time, our financial sector is ‘cushioning the blow’. For our future, this sector will be critical.

Improving our productivity performance will be critical to create a new normal and to do better. This will require a renewed investment effort and reforms to increase digitisation, business model updates, and reinvention with innovation in new products, new services and new ways of doing things.

At a firm level, in the here and now, this is about survival – planning your cash and assets, and for your people.

At a market level, this is strategic – what scenarios could there be for the market at the other end? A new take on M&A, perhaps? A new understanding of market structures which may have become more concentrated, or more disaggregated as a result of structural changes which may have occurred.

At an economy level, this will be about new foundations – of markets, of production, of consumption, and of skills.

Coming out of this crisis, Australia must embark on new reforms to lift sustainability and productivity. Our gift is to make choices to unleash innovation, recapitalise, and set a course for new economic growth.

Globally, we must handle the trend of deglobalisation and inward shift to nationalism, carefully. As a small, open, economy, Australia has thrived under globalisation and rules based orders. As a middle power, Australia can refashion globalisation for progress as collective will.

Whatever the choices we make for recovery and growth, the role of the financial services sector will be critical, with growth and innovation being the hallmarks of its future.

Dr Pradeep Philip – Deloitte Access Economics
Endnotes

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