PwC's Major Banks Analysis, November 2013

Banking on a better future

$27.4bn

Underlying cash earnings

15.9%

Return on equity, up from 15.5% (YOY)

5.4%

Increase in non-interest income for FY13

pwc

www.pwc.com.au

Can it get better than this?

FY13 has been another strong year of results for the Australian major banks reflecting solid profit growth in both the first and second halves. They have increased underlying cash earnings by 9.5% year-on-year (yoy) to $27.4bn. This translates to 4.2% growth in second half underlying cash earnings relative to the first half (hoh). We have seen an uptick in return on equity to 15.9% for FY13 from 15.5% for FY12.

The environment in which these results have been delivered is broadly consistent with conditions prevailing in the previous year, albeit with a somewhat more positive global backdrop. In particular, the concerted effort by central banks to maintain accommodative monetary policy has helped maintain a 'risk on' mood in financial markets and a broadly stable trend in global economic growth. China has held up better than many were expecting a year ago.

The great uncertainty at present is what will happen to market sentiment once central bank 'tapering' commences? A quick shift to 'risk off' in June and July underpinned how sensitive markets are to that news. But for the moment it seems some months away and the Australian banks are clearly very alive to managing their exposures with these risks in mind. If anything, the tone of central bank statements globally in recent weeks has been skewed towards further monetary accommodation.

The 'risk on' mood in global markets has helped to drive positive equity market sentiment in Australia, which has been broadly supported by profit reporting. Yet measured economic growth has been on a slowing trend, with gross domestic product growth a relatively modest 2.6% for the year to June as resources investment and public sector expenditure slowed. Other drivers of domestic demand are muted, despite the impact of record low official cash rates. Housing construction is however on a positive trend, with the value of approvals for new residential construction rising by 11.1% over the year to September 2013.

Housing market

The positive sentiments we are seeing globally and the end of prolonged election process are translating into improved household and business confidence. One area where sentiment has improved markedly is the housing market, where weighted capital city prices have increased by 7.6% in the year to September 2013. Low interest rates, strong population growth, firm labour market conditions and weak growth in the stock of housing are all objective factors underpinning both house price and rent increases. In addition, there appears to have been a shift in expectations about future price increases, including by investors.

There is no doubt that competition among lenders for mortgages and indeed corporate mandates has increased in the past year as evidenced for instance by higher payments to brokers and 'cash back' payments to new borrowers. However, we have not seen any recent evidence of an increase in >80 per cent LVR loans or any material deterioration in lending standards, which is no doubt helped by APRA's focus in this area. This suggests that current speculation around a 'credit-induced bubble' is premature.

Notwithstanding this, the ratio of household debt to income is virtually unchanged over the past five years and remains at extremely high levels by historical standards. This makes borrowing households vulnerable to either a rise in interest rates or unemployment.

The fact that banks are well insured, provisioned and capitalised in the event that either of these situations arise, does not change either the economic or social pain which would follow should such a shake-out occur.

It is also worth noting that 'bubble talk' is not confined only to Australian housing – it extends to other housing markets (such as NZ and the UK) and certain equity markets (such as the US S&P 500 index which was up 26% over the year to date). Given fresh memories of pre-GFC euphoria, and easy global monetary policy, this is not too surprising.

Major banks performance

In terms of the detail, net interest income has improved 2.8% hoh and non-interest income remained largely flat. Costs exhibited a march upwards, increasing 4.2% hoh and the bad debt charge fell as the credit environment remained benign.

Slow credit growth continues to be a constraining factor on the banks' results. Overall credit grew 3.3% pa in the year to September 2013, which was identical to September 2011 and below the 4.0% seen in the year to September 2012.

Owner occupied housing up 4.2% pa

Investment housing up 6.1% pa

The banks achieved above system loan growth, but at the expense of margin. Lending assets grew by 4.1% hoh while margins fell 2 basis points (bps) to 2.12% for 2H13. The fall in margins is mainly due to increased competition for institutional/corporate lending and increased deposit costs. The reduced margin benefit of transaction accounts due to low interest rates continues to have an adverse impact on net interest margins.

Other areas of revenue affecting the results include:

- Wealth management returns grew by 6.4% hoh reflecting increasing inflows and improved underlying asset performance in funds under management. This was partially offset by weaker performance in life insurance which is experiencing increased lapse rates and claims.
- Bank trading income was down 12.7% hoh and up 29.3% yoy. Continued demand from customers for risk mitigation products has been a noticeable positive, as was the growth in trading income from offshore expansion initiatives.
- Fees and commissions' steady decline appears to have been halted. Overall fees and commissions increased 1.8% hoh, with lending fees picking up 3.0% hoh, a reflection of increasing demand for commercial and corporate lending products.

The banks' discipline on cost management in response to low credit growth is delivering some efficiency dividends. However, there are underlying cost pressures relating to staff costs per head and investment in technology. The cost-to-income ratio is now at 45.6% compared to 44.6% at March 2013. Staff expenses increased 2.3% hoh, while technology expenses rose by 4.9% hoh.

The bad debt expense has continued its recent downward trend, dropping a further 15.7% in the last six months. This reflects a continuation of improving delinquencies in the retail portfolios, assisted by low interest rates. Impaired assets continue to run down as impaired loans are worked-out, partly offset by some newer small business and corporate loans falling into arrears.

As we look forward, we see unemployment as the biggest risk to the bad debt expense. It is interesting to note that currently the banks are writing higher levels of investment loans. While the recent increases in property prices provide some protection on the downside, and the fact that we are not seeing any deterioration in the serviceability criteria being applied to new loans, the possibility exists of higher latent risk in the bank's lending portfolios.

Longer-term the bad debt expense to loans and acceptances ratio is likely to be in the range of 25 – 35 bps.

Outlook

In our view, the Australian banks remain well placed to meet the challenges ahead. They are continuing to focus on customers through digital initiatives, better customer analytics and evolving ideas about the role branches play.

As we look forward, one thing is certain. We will see more change. It is going to be interesting to see how the Coalition government executes against its promise of a Financial Sector Inquiry and the actions that arise from the G20 in particular, which Australia chairs in 2014.

Looking to the more immediate future, the PwC Banking Gauge – a consensus view across four leading banking analysts – predicts that the four major banks will deliver cash earnings growth of 5.0% in FY14 and 5.5% in FY15.

Note: PwC Banking gauge is a consensus view across four banks with four of Australia's leading analysts – Brian Johnson (CLSA), James Ellis (Credit Suisse), Jonathan Mott (UBS), and Scott Manning (JP Morgan).

Four majors' combined performance – A$ million – underlying cash earnings

	2013	2012	13 vs 12	2H13	1H13	2H vs 1H
Net interest income	53,035	51,127	3.7%	26,884	26,151	2.8%
Other operating income	26,054	24,711	5.4%	13,072	12,982	0.7%
Total income	**79,089**	**75,838**	**4.3%**	**39,956**	**39,133**	**2.1%**
Operating expense	35,678	34,611	(3.1%)	18,206	17,472	(4.2%)
Core earnings	**43,411**	**41,227**	**5.3%**	**21,750**	**21,661**	**0.4%**
Bad debt expense	5,060	6,174	18.0%	2,315	2,745	15.7%
Tax expense	10,805	9,907	(9.1%)	5,380	5,425	0.8%
Outside equity interests	110	92	(19.6%)	58	52	(11.5%)
Underlying cash earnings after tax before significant items	27,436	25,054	9.5%	13,997	13,439	4.2%
Statutory results	26,217	22,803	15.0%	13,792	12,425	11.0%

A time to inquire

A major focus for financial services over the coming year will be the Australian Government's inquiry into the financial services sector, whose terms of reference should be released shortly.

We expect that this inquiry will span the entire breadth of financial services, reflecting the blurring of boundaries between providers, markets, and products. In some sectors, such as superannuation, it will be possible to draw on recent inquiry work, specifically the 2009/10 Cooper review. However, in other sectors like insurance it has been a very long time since an inquiry was conducted. Indeed there was little focus on insurance by the Wallis Committee (1997). The Wallis Committee did put a big focus on technology trends and that focus will certainly feature heavily here.

This next review is particularly well timed. The dust has settled sufficiently since the depths of the GFC in 2008/09, while the long-lasting impacts of both the cycle leading into the GFC and the GFC itself, have become much better understood. It is becoming increasingly well appreciated that on all sorts of dimensions the next 30 years will differ greatly from the last 30 years. It is this differentiation that presents the right backdrop for an inquiry like this.

Some of the differences include aging populations in many countries, increasing pressure on public finances and a further shift in economic power to emerging economies. Not to mention a far more digitalised economy and the ongoing process of adjusting to much higher household debt in many economies.

These differences do not only extend to broader economic trends. They also reach to the operation of the financial system itself, and its impact on the broader economy, which has changed in recent decades. This goes much deeper than simply technology and the changing competitive position of sectors and institutions.

For instance, the GFC has driven inevitable shifts in general perceptions about the dividing line between public and private risk. This is not only a banking issue in terms of who wears the cost if a bank gets into trouble (moral hazard). Increasingly, it is also becoming an insurance issue as well, nicely summed up in a recent Washington Post article describing the US federal government as "an insurance conglomerate protected by a large, standing army".

Likewise, the very construct of co-ordinated, and potentially open-ended, global quantitative easing represents an enormous departure from policy precepts of a few years ago. A further example is recent policy discussion about central banks having fewer degrees of freedom to set domestic interest rates relative to the US fed funds than historically assumed even with floating exchange rates and free capital flows.

All of these considerations reinforce the indications to date that the terms of reference for this inquiry will be a 'root and branch' review of the entire sector and of its linkages to the broader economy.

Against this background our view is that the core focus of inquiry should be on how best the financial services sector can contribute to maintaining Australia's strong economic growth record in coming decades.

The importance of the financial services sector extends to all aspects of economic activity, not just growth.

In particular, issues relating to productivity and competition, and to governance and risk, need to be considered. Moreover, given that contract law lies at the heart of all financial products, the inquiry will need to have a substantial legal focus.

A potential framework for inquiry

Bringing this together, one potential framework would be to focus on three core dimensions:

1. Growth and innovation – how can the financial system best support growth and innovation in the economy?
2. Productivity and competition – how can productivity in the sector be maximised, and how can competition ensure that those efficiencies flow through to end users?
3. Governance and risk – what are the right risk settings and governance standards for the sector overall?

One advantage of this framework is that each of these three dimensions are deeply relevant to both financial services providers and to the economy overall. The essence of the competitive strategy for all financial services organisations involves deciding how to trade-off between growth, productivity, and risk dimensions. The same trade-offs apply at the national level as well.

For instance, above-trend credit growth might assist economic growth initially but may create risks which undermine growth over time. Alternatively, excessive regulatory governance can undermine innovation and growth while, as APRA is fond of reminding us, the wrong sort of short-term productivity measures can result in poor risk decisions, potentially with system-wide implications.

Such a framework would therefore enable explicit consideration of the inevitable trade-offs which will need to be made by this inquiry, including re-evaluating the right boundaries for government in financial services and assessing the 'level playing field'.

Fundamentals integral to maintaining Australia's economic performance

Absolutely critical to maintaining Australia's strong economic record are the fundamentals of ensuring sufficient access to debt, equity and other risk capital to fund Australia's growth in a post-GFC world. Key considerations include:

- Whether the overall structure of economic incentives is consistent with investment in those areas with the best long-term benefit to the economy. For instance, are incentives and regulatory settings skewing too much investment to high-end housing at the expense of entry-level housing or other forms of investment?
- How do we ensure that superannuation assets are directed to long-term, productive investments, given our mandated superannuation system?
- How do we make sure the aggregate flow of domestic and offshore savings are sufficient to meet Australia's long-term investment needs, including ensuring banks have access to sufficient funding and liquidity sources which are Basel III compliant, especially as demand for credit picks up?
- In turn, how to make certain there is appropriate regulatory and taxation neutrality between alternate savings vehicles, such as deposits?
- What is the right private/public balance of investments and incentives to guarantee our long-term infrastructure needs are met efficiently and reliably?
- How does the digital revolution change how new investments are funded? For instance, intangibles are likely to generate a higher proportion of value-add, and traditionally banks have struggled to value these intangibles for lending and security purposes.
- How big a gap is the absence of a venture capital market, or a deep corporate bond market, in Australia?

As noted earlier, the insurance sector dimension of this inquiry will be particularly important as the trend towards the increased cost of natural disasters is clearly putting pressure on insurance affordability. How actively should government be investing in pre-disaster resilience to reduce expected losses and how should this be funded? How would reduced insurance affordability impact systemic credit risk in bank housing portfolios?

This inquiry will have an enormously important responsibility to fulfil. The financial services sector has always had a fundamental impact on the operation of the economy, but the operation of the sector itself has never been so complex. Likewise, sources of growth, value, and innovation in the global economy are changing dramatically.

The recommendations of the 1981 Campbell Inquiry into banking have been so enduring precisely because it anticipated so clearly where the world was headed in the post Bretton-Woods era of floating exchange rates and mobile capital, making the case for Australia to move in line with these trends. The challenge for this inquiry will be to be just as far sighted.

Net interest income

Credit growth

Credit growth remained stubbornly low for the fifth year in a row at 3.3% for the year to 30 September 2013. This is lower than the 4.0% pa achieved in the year to September 2012 and the same as the year to September 2011.

Housing credit growth finished the year to September 2013 at 4.8% pa, the same as a year ago, having dipped down to 4.4% pa at March 2013. Recent Reserve Bank estimates suggest that the impact of borrowers using lower interest rates to reduce borrowings has decreased the growth in credit by between ½ and ¾ of a percentage point, meaning banks need to 'peddle harder' than ever to maintain balance sheet loan growth.

Owner occupied lending grew 4.2% pa to September 2013, similar to a year ago. The main contributors to new lending are existing home owners, with New South Wales, Victoria and Queensland all recording increased activity. First time home buyers (FTHB) activity has dropped off. New loan approvals to FTHB fell to 13% of all approvals in the month August 2013, well below the longer-term trend of 17% – 19% per month and the highs of 30% plus seen in mid 2009 when state and federal government assistance drove higher than usual growth in this sector. This fall in FTHB participation reflects continued changes to assistance at the state level, concerns around rising unemployment and renewed house price growth.

Investment property, which now accounts for about a third of all housing credit, recorded the strongest growth of any lending sector, at 6.1% pa for the year to September 2013, up from 5.3% a year ago and better than it's been since mid 2011. Stronger housing price growth, firm rental yields, increasing interest from SMSFs and low interest rates have seen loan approvals for this sector growing 18% by value in the year to August 2013.

Other personal lending grew 1.0% pa to September 2013, the best it has been since June 2011.

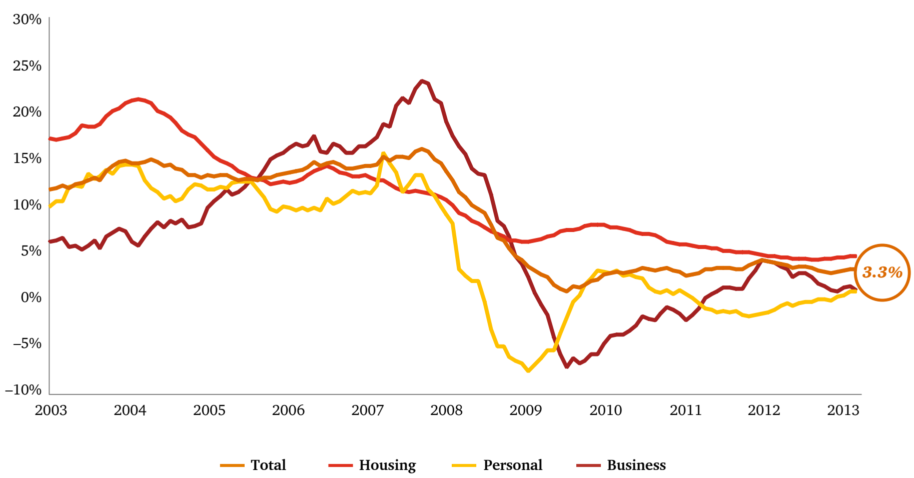
Business credit growth remained weak at 1.1% pa for the year to September 2013, down from 3.7% pa for the year to September 2012. However this has been a year of two halves. In the six months to March 2013 business credit went backwards, contracting 0.9% on an annualised basis. Whereas in the six months to September 2013 business credit recovered lost ground, growing at 2.8% on annualised basis, to finish $7b up on last year. What will happen next is unclear as the cycle of bursts of growth followed by periods of retraction seems to be continuing.

Competition for corporate lending mandates is being reflected in tighter pricing.

The major banks combined market shares across all sectors of credit have remained broadly steady at 78% for housing loans, 61% for personal lending and 76% for business credit.

The question to be asked is whether we passed the low point in business lending growth earlier this year?

Domestic credit growth (Annual % growth – 12 month rolling average)



Source: RBA data

Deposit growth

Total bank deposit growth of 8.2% pa for the year to September 2013 was down a little from the 9.9% pa seen in the year to September 2012.

Bank deposits were only just sufficient to fund new bank lending in the year to September 2013. The core bank deposit to bank loan ratio edged higher to 70.8% at September 2013.

The reasons for this slow down in deposit growth is a tale in two parts.

Household deposits continued to grow in line with our expected trend of between 7% – 10%, at 8.8% pa for the year to September 2013, down a little from 9.2% pa recorded in the year to September 2012. No doubt both improving equity returns and lower deposit rates due to record low interest rates have impacted on growth over the last six to twelve months.

However, business deposit growth remained weak at 2.5% pa in the year to September 2013, similar to the 2.8% pa recorded a year ago but well down on the 12.9% pa recorded 2 years ago in September 2011. This is no doubt a reflection of the prevailing weaker business conditions impacting cash flows.

This situation is unlikely to change until there is a sustainable increase in business activity over a reasonable period of time.

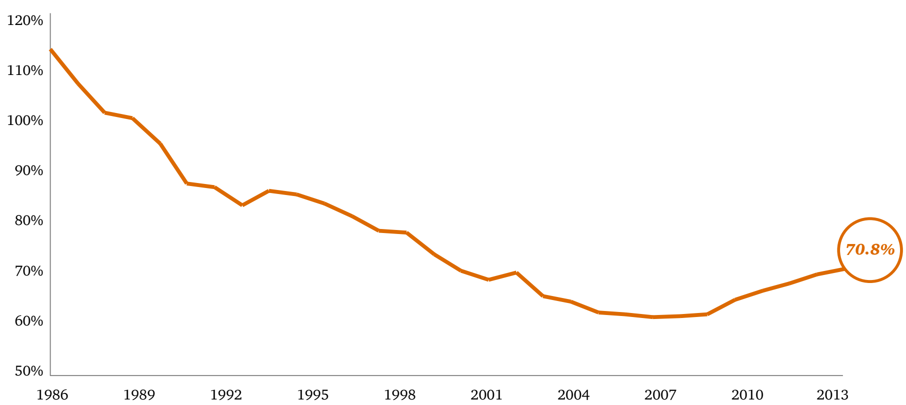
Banks continue to manage their long term wholesale debt portfolios to maximise market opportunities and ensure that periods of increased market volatility can be weathered. This may result in tapping the short term markets to manage timing differences and market disruptions, as in June/July in this year. We expect that markets and regulators alike will watch this dynamic closely to ensure the banks don't permanently increase their reliance on short term funding.

The banks' continued access to reasonably priced funds from the long term-debt markets will be critical as the economy looks to them to do the heavy-lifting in terms of meeting the demand for credit from the business sector as and when business activity gathers pace. The average funding costs for the banks' long term debt portfolios are at or near their maximum (around 120 bps –150 bps) and should stabilize or reduce as more expensive debt is retired.

The major banks market share of deposits was steady across both household deposits at 81%, and business deposits at 80%.

The low growth in business deposits is unlikely to change until we see a sustainable pick up in business activity over a reasonable time.

Core bank deposits to bank loans and advances (%)



Net interest margin

Net interest income increased 3.7% yoy and 2.8% hoh. This reflects respectable growth in gross loans and acceptances, up 5.5% yoy (4.1% hoh).

The banks continue to show agility in growing loans faster than total system credit growth. However, the income benefit from increased volumes was offset by a contraction in the banks' combined net interest margin of 4 bps yoy (2 bps hoh). This was a result of continuing deposit competition and lower interest rates offsetting gains from asset re-pricing at the beginning of the interest rate easing cycle.

For FY13 the banks combined net interest margin was 2.13%, and for 2H13 it was 2.12%. The 2.12% recorded for 2H13 is the lowest it has been since the second half of 2008, before loans were re-priced to reflect the re-pricing of credit at the beginning of the GFC.

Looking more closely, the component parts of the banks' combined net interest margin have moved as follows:

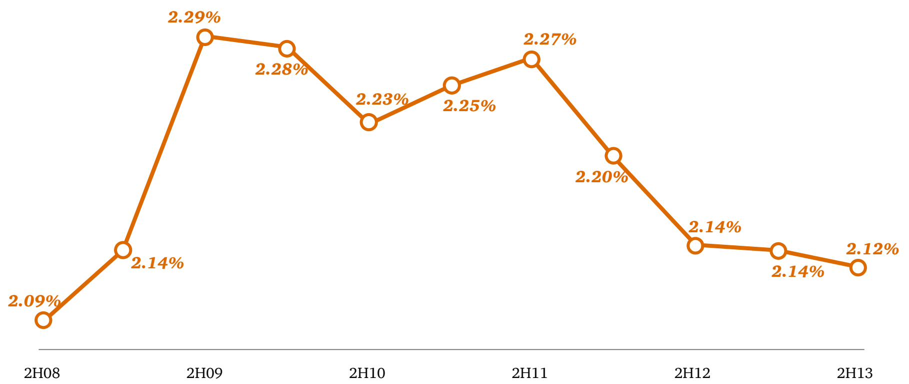
- Asset re-pricing, particularly in the first half added 8 bps yoy (0 bps hoh) and improvements in the asset mix added a further 1 bps yoy (1 bps hoh).
- Price competition for deposits reduced the margin by 6 bps yoy (1 bps hoh) and higher wholesale funding costs in the first half contributed a further 5 bps decline yoy (0 bps hoh).
- Global markets and treasuries' risk management operations further reduced margins by 1 bps yoy.

We continue to expect further downward pressure on net interest margins driven by competition for lending in a subdued market and competition for deposits driven by funding and regulatory requirements.

The low interest rate environment puts further pressure on margins as it reduces the benefit received from low interest forms of funding such as transaction accounts and equity. Low interest rates seem set to remain in place for the time being.

We continue to expect further downward pressure on the net interest margins and low interest rates seem set to remain in place for the time being.

Combined net interest margin



Other operating income

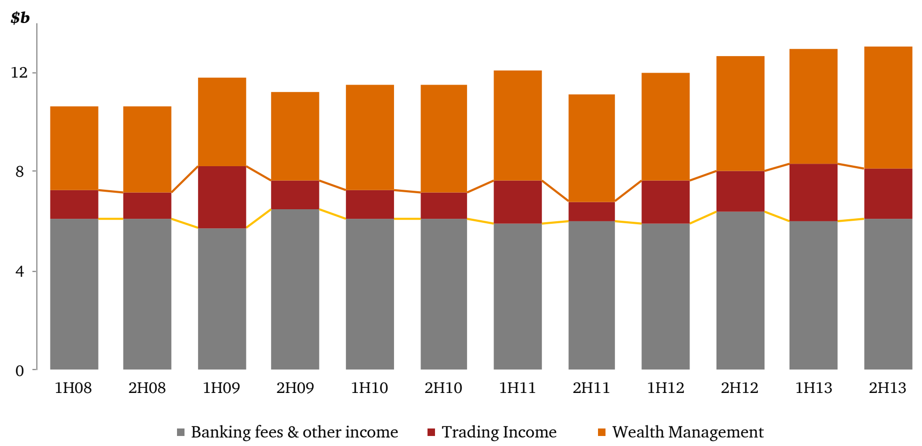
Trading income outperformed expectations increasing 29% in FY13. Strong customer demand for risk management products and adjustments for favourable credit spreads contributed to the out-performance.

Fees and commissions grew by 1.8% this half, reflecting higher fees from commercial and corporate banking.

Other operating income grew 5.4% in FY13, but was flat half on half.

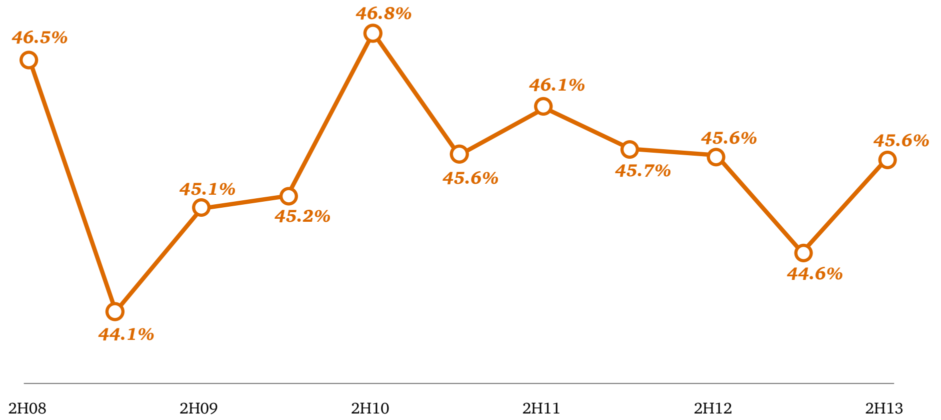
The wealth management operations delivered solid revenue growth in FY13. Funds management income grew 8.6% as equity markets improved and inflows picked up. Insurance income increased 5.4% despite some adverse claims and attrition experience.

Analysis of other operating income



Expenses

Combined expense-to-income ratio



Full year expenses were up 3.1%, which compares favourably with 3.9% in 2012 and 3.4% in 2011.

Productivity continues to be a major focus for the banks with the expense to income ratio improving 50 bps to 45.1% in FY13. Some ground was lost in the second half with the ratio increasing 100 bps compared to the first half.

Capitalised software balances now stand at $8b, up 24% from FY12. The related amortisation expense increased 17.5% in FY13.

The number of employees fell 1.1% over the year to 170,242. Average salary costs per person rose 2.5 % in FY13 and 3.1% hoh as cost increases outpaced staff reductions.

Asset quality

Banks asset quality indicators continue to improve.

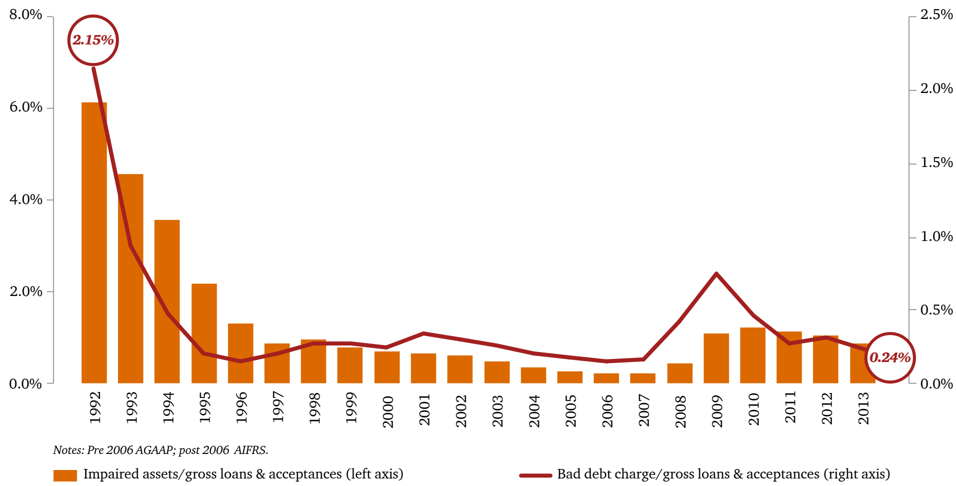
Gross impaired assets to gross loans crept down 6 bps in the second half, as banks work through impaired assets and fewer new problems emerge.

Loans 90 days past due improved 7.4% over the year, to $9b, reflecting lower interest rates.

Banks are well provisioned, with the total provisions to loan ratio sitting at 0.8%, down 9 bps from 2012, reflecting a higher quality portfolio.

The bad debt expense fell 18% for the year, reflecting the benign credit environment.

Impaired assets and bad debt expense



Notes: Pre 2006 AGAAP; post 2006 AIFRS.

On culture and risk

Culture can mean many things ... Opera. Cricket. Yoghurt. But however it is defined, in business culture is generally accepted as essential to organisational performance – a key reason why businesses perform differently – fewer compliance issues, better safety records, more consistent financial performance, and happier customers.

In global financial services, it seems culture is answerable for many of the questionable practices of the past decade – from Libor rigging to product mis-selling to the very heart of the US mortgage crisis. So it should be no surprise that regulators, including APRA are turning their attention to the role culture plays in financial services risk management (see APRA's recently released *CPS220 Risk Management).*

The challenges of influencing culture are threefold.

1. It is intangible; you can't see the culture in advance of any trouble. But after the event, a remarkable aspect of human nature is that everyone has an opinion on the culture that drove a scandal.
2. Culture means different things to different people – risk cultures, performance cultures, and customer service cultures. How do you align strategic objectives and the culture which is most appropriate for achieving them without impacting other parts of your organisation's culture?
3. None of this makes any difference unless you take action, but getting traction is easier said than done. Whilst people will have no difficulty in advising you about the culture of your business; and flooding you with complex framework models of organisational culture, advice on practical actions is harder to come by.

A distinct challenge for financial services organisations is that holding and transforming risks on their balance sheets is the essence of their business and, as a consequence of this, measurement is the precursor to action. The lack of a tangible handle on the culture – the set of beliefs, skills and environmental factors that drive an organisation's risk taking behaviours – can stall action.

The global response to the GFC has been a tsunami of new regulation; rules have been beefed up, loopholes in the law closed; and more disclosure required. Yet, the real challenge lies in the 'white space' – the space between the board's articulation of risk appetite, business strategy and risk tolerance and what front-line troops understand as the priorities in their day-to-day work. That extent of 'white space' has been shown to correlate strongly with poor performing businesses. Culture is not divorced from the context of process and systems within which people operate.

Articulating the culture within an organisation is a step towards changing it. To get started, an important, but simple question to ask is – "why do people do what they do?" This sounds easy given that we all have intuitive feelings and opinions about almost everything that comes our way. The disciplined approach is to focus on observable behaviours and their causes.

'Risk culture'– what really drives employee behaviour and what can be done to shape it.

What are the drivers of human behaviour?

In an organisational context there are four primary drivers of how people go about their work– three of which are rational and unique to every organisation (or group or team) and one that is generic to all humans but much harder to predict.

1

People really do try to do what they believe they are supposed to do. Unfortunately they don't work this out by reading the risk and controls manual. Instead they observe how others actually act, listen to what they say and also absorb the formal company position. From these signals they figure out what 'normal' behaviour is in their organisation, or at least, what they can get away with.

If the biggest rewards go to those with the highest sales or other 'hard' metrics, irrespective of other behaviours, then people work out that behaviours don't count as far as personal rewards go. If it's ok to cut corners with a pre-deal credit check, it's probably ok to cut corners on bigger issues too.

Of course, in making those judgements individuals pay greater attention to the example set by some than by others, and in particular by the leaders. This gives leaders a powerful tool and also a heavy responsibility.

2

Just as a sportsperson can only perform within certain limits, employees can only do what they have the capability and capacity to do. A group's capability influences it behaviours in two important ways:

- it predicts the likely behaviour of the group because people gravitate towards activities at which they are particularly skilled or enjoy performing;
- conversely, capability gaps point to risks. An employee struggling to understand or process a mountain of work is a customer service disaster or unacceptable credit or operational risk waiting to happen.

3

The third driver of behaviour is the environment in which people operate even when they are adequately skilled and understand what is expected. The systems they use, the organisation's structure, staffing levels, the physical workplace layout all shape individual actions.

Of course, these environmental factors reinforce peoples' beliefs about what is important to the organisation – if performance is important why isn't performance management used more rigorously? If people are truly our most important asset, why do we start thinking about getting rid of them at the first sign of a downturn?

4

The fourth and final factor is the simple reality that people are people with all the variability that this brings. We are prone to following the latest example, to trading off significant long-term gain for the avoidance of relatively short term pain, to shying away from complex issues, and to having personal overconfidence in spite of clear evidence to the contrary.

The fact that these apparently irrational 'people are people' biases are ever-present means that they inevitably magnify weaknesses in the ways in which organisations manage the three, more rational drivers we have just discussed. Hence the importance of concentrating on each of those three areas.

The good news is that we are seeing more and more organisations focus on these drivers and behaviour and consciously take deliberate and explicit choices to encourage the right behaviours. We are also seeing greater sophistication in the measurement and analysis of these drivers, even to the extent that some organisations are borrowing tools from anthropology and ethnography.

Sophisticated analysis is great, but remember when it comes to achieving alignment in any team or organisation, it's simplicity and consistency which counts for most. Focus on figuring out what drives employee behaviours and how to use that knowledge to help them succeed at work. Do they believe what is being asked of them is fair and reasonable? Are there objective capability constraints? Are the tangible and intangible rewards and incentives combining in the right ways to encourage the desired outcomes?

Lastly, it is important to focus on influencing positive change, and never assuming culture is fixed. Provide consistent messaging and actions to help people understand what is expected of them and what is acceptable. Focus on recruitment and training so that the right basics are in place and look rigorously and consistently at all aspects of the employee experience to consciously influence the behaviour they exhibit.

Key thought leadership in the market

Protecting prosperity: Why we need to talk about tax

Australia faces a historic choice in the years ahead. It could cut government services radically, it could build tax revenues by incremental change, or it could prioritise growth through carefully targeted expenditure cuts and tax reform.
www.pwc.com.au/tax/tax-reform

Navigating to tomorrow: serving clients and creating value: Global Private Banking and Wealth Management Survey 2013

This year's 20th Anniversary issue of PwC's Global Private Banking and Wealth Management Survey gathered insights and perspectives on critical aspects of the challenges confronting participants across all segments of global wealth management. 200 firms from 51 countries participated in English, French, German, Spanish, Portuguese, and Mandarin. Their combined responses yield a fascinating self portrait of global wealth management both now and into the coming years.
www.pwc.com/wealth

FS Connect iPad App

Download the FS Connect iPad App to find a wealth of publications, industry insights and news around the financial services sector published in Australia and globally.

Available on the App Store

Scan the QR Code with your iPad or search ***FS Connect*** on the App Store.

pwc.com.au/mba

National

Hugh Harley
Financial Services Leader
hugh.harley@au.pwc.com
+61 (2) 8266 5746

Sydney

Stuart Scoular
Banking and Capital Markets Leader
stuart.scoular@au.pwc.com
+61 (2) 8266 5498

Melbourne

John Dovaston
john.dovaston@au.pwc.com
+61 (3) 8603 3820

Brisbane

Michael O'Donnell
michael.odonnell@au.pwc.com
+61 (7) 3257 5149

Adelaide

Kim Cheater
kim.cheater@au.pwc.com
+61 (8) 8218 7407

Perth

Justin Carroll
justin.carroll@au.pwc.com
+61 (8) 9238 5240

New Zealand

Sam Shuttleworth
sam.shuttleworth@nz.pwc.com
+64 (9) 355 8119

For further information on Risk and Culture, please contact:

Jon Williams
jon.williams@au.pwc.com
+61 (2) 8266 2402

Richard Gossage
richard.gossage@au.pwc.com
+61 (3) 8603 5360

For further information or copies of this report, please contact:

Megan Abel
megan.abel@au.pwc.com
+61 (2) 8266 0088

This document is provided by PwC as general guidance only and does not constitute the provision of accounting, legal advice, tax services, investment advice, or professional consulting of any kind. The information is provided "as is" with no assurance or guarantee of completeness, accuracy or timeliness of the information and without warranty of any kind, express or implied, including but not limited to warranties of performance, merchantability and fitness for a particular purpose. In no event will PwC or its professionals be liable in any way to you or to anyone else for any decision made or action taken in reliance on the information or for any direct, indirect, consequential, special or other damages related to you or your use of information, even if advised of the possibility of such damages. Before making any decision or taking any action, you should consult a professional adviser who has been provided with all the pertinent facts relevant to your particular situation.

© 2013 PwC. All rights reserved.
PwC refers to the Australian member firm, and may sometimes refer to the PwC network.
Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

Liability limited by a scheme approved under Professional Standards Legislation.

Key banking statistics – Full year 2013

	ANZ			CBA (iv)			NAB (v)			WBC		
	12 mths Sep-13	12 mths Sep-12	12 mths Sep-11	12 mths Jun-13	12 mths Jun-12	12 mths Jun-11	12 mths Sep-13	12 mths Sep-12	12 mths Sep-11	12 mths Sep-13	12 mths Sep-12	12 mths Sep-11
Balance sheet												
Total assets	702,991	642,127	604,213	753,876	718,859	667,899	808,427	763,090	753,757	696,603	674,965	670,228
Risk weighted assets	339,265	300,119	279,964	329,158	302,787	281,711	362,078	331,336	341,069	307,372	297,901	279,961
Gross Loans and acceptances	472,962	431,566	402,797	568,821	542,097	518,075	521,757	500,857	482,125	539,806	518,279	500,654
Asset quality & provisioning												
Gross impaired assets	4,264	5,196	5,581	4,330	4,687	5,297	6,347	6,543	6,386	3,600	4,386	4,616
Net impaired assets	2,797	3,423	3,884	2,571	2,556	3,172	4,317	4,560	4,840	2,046	2,745	2,953
Gross impaired assets as a % of gross loans and acceptances	0.90%	1.20%	1.39%	0.76%	0.86%	1.02%	1.22%	1.31%	1.32%	0.67%	0.85%	0.92%
Individually assessed provisions	1,467	1,773	1,697	1,628	2,008	2,125	2,030	1,983	1,546	1,364	1,470	1,461
Individually assessed provisions as a % of impaired assets	34.4%	34.1%	30.4%	37.6%	42.8%	40.1%	32.0%	30.3%	24.2%	37.9%	33.5%	31.7%
Collective provisions	2,887	2,765	3,176	2,858	2,837	3,043	2,795	2,920	3,064	2,585	2,771	2,953
Collective provisions as a % of non-housing loans & acceptances	1.31%	1.38%	1.69%	1.46%	1.50%	1.67%	1.20%	1.26%	1.34%	1.46%	1.61%	1.76%
Total provisions	4,354	4,538	4,873	4,486	4,845	5,168	4,825	4,903	4,610	3,949	4,241	4,414
Total provision as a % of gross loans & acceptances	0.92%	1.05%	1.21%	0.79%	0.89%	1.00%	0.92%	0.98%	0.96%	0.73%	0.82%	0.88%
Profit & loss analysis (i)												
Net interest income	12,772	12,110	11,498	13,944	13,157	12,645	13,407	13,297	13,092	12,912	12,563	12,169
Other operating income	5,606	5,738	5,314	7,401	6,844	6,893	7,126	6,616	6,123	5,921	5,513	4,954
Total operating expenses	8,236	8,519	7,718	9,605	9,196	8,891	10,127	9,517	9,595	7,710	7,379	7,106
Core earnings	10,142	9,329	9,094	11,740	10,805	10,647	10,406	10,396	9,620	11,123	10,697	10,017
Bad debt expense	1,197	1,258	1,211	1,082	1,089	1,280	1,934	2,615	1,822	847	1,212	993
Profit before tax	8,945	8,071	7,883	10,658	9,716	9,367	8,472	7,781	7,798	10,276	9,485	9,024
Income tax expense	2,437	2,235	2,222	2,928	2,676	2,597	2,337	2,178	2,142	3,103	2,818	2,655
Minority Interest	10	6	9	16	16	16	8	1	1	76	69	68
Cash earnings after tax before significant items (underlying profit)	6,498	5,830	5,652	7,714	7,024	6,754	6,127	5,602	5,655	7,097	6,598	6,301
Statutory results (ii)	6,272	5,661	5,355	7,677	7,090	6,394	5,452	4,082	5,219	6,816	5,970	6,991
Key data												
Other operating income as a % of total income	30.5%	32.1%	31.6%	34.7%	34.2%	35.3%	34.7%	33.2%	31.9%	31.4%	30.5%	28.9%
Interest Spread	1.98%	2.02%	2.12%	1.91%	1.82%	1.83%	1.69%	1.71%	1.80%	1.92%	1.88%	1.90%
Interest margin	2.22%	2.31%	2.42%	2.13%	2.09%	2.12%	2.02%	2.11%	2.24%	2.15%	2.17%	2.22%
Expense/income ratio (as reported ratio)	44.8%	47.7%	45.9%	45.0%	46.0%	45.5%	42.6%	41.3%	43.7%	40.9%	40.8%	41.5%
Total number of full time equivalent staff	47,512	48,239	50,297	44,969	44,844	46,060	42,164	43,336	44,645	35,597	35,675	37,712
Operating costs per employee (dollars) – annualised	172,030	172,911	158,487	213,889	202,323	195,224	238,042	219,069	212,490	214,739	204,739	186,531
Return on average equity (as reported)	15.3%	15.1%	16.2%	18.4%	18.6%	19.5%	14.5%	14.2%	15.2%	16.0%	15.5%	16.0%
Return on average assets (underlying cash)	0.96%	0.93%	0.99%	1.06%	0.99%	1.02%	0.76%	0.74%	0.80%	1.04%	1.00%	1.00%
Capital ratios (iii)												
Common equity	8.5%	8.8%	8.5%	8.2%	7.8%	7.7%	8.4%	8.3%	7.6%	9.1%	8.4%	8.1%
Tier 1	10.4%	10.8%	10.9%	10.2%	10.0%	10.0%	10.4%	10.3%	9.7%	10.7%	10.3%	9.7%
Tier 2 (net of deductions)	1.8%	1.4%	1.2%	1.0%	1.0%	1.7%	1.5%	1.4%	1.6%	1.6%	1.4%	1.3%
Total	12.2%	12.2%	12.1%	11.2%	11.0%	11.7%	11.8%	11.7%	11.3%	12.3%	11.7%	11.0%
Funding Ratios												
Deposits (exclude CDs) / gross loans	77.8%	75.7%	73.8%	71.2%	70.0%	66.9%	70.1%	67.7%	64.6%	70.9%	67.1%	61.9%
Deposits (exclude CDs) / total liabilities	55.9%	54.4%	52.5%	57.2%	56.0%	55.0%	48.0%	47.1%	43.8%	58.9%	55.3%	49.5%

All figures in AUD million unless otherwise indicated

(i) In arriving at 'underlying profit', income and expenses exclude significant items and certain non cash items. Non cash items include acquisition related adjustments, impact of hedge accounting and revaluation of treasury shares and other items reported by the banks. Significant items include the impairment of software and goodwill, restructuring and transformation costs and other items reported by the banks. Some components of income and expenses have been reclassified to improve comparability between banks.

(ii) Statutory result as reported by the banks, unadjusted.

(iii) Capital ratios for 2013 are prepared in accordance with Basel III, and capital ratios for 2012 and 2011 are prepared in accordance with Basel II.

(iv) In reporting CBA's underlying earnings we have excluded the impact of investment earnings on shareholder's retained profits and capital in life business from other operating income and the related tax impact: FY13 $105 million, FY12 $89 million and FY11 $81 million.

(v) NAB's underlying cash earnings after tax before significant items are shown before distributions to holders to National Securities; and excluding investment earnings on shareholder's retained profits and capital in life business and related tax impact - FY13 ($188) million and ($3) million, FY12 ($207) million and $38 million and FY11 ($225) million and $30 million.