Banking Matters

# Striking the balance

## Stability and agility in uncertain times

Major banks are demonstrating steady yet pressured performance, striving to balance stability with agility in these uncertain times.

Major Banks Analysis Half-Year | May 2025

pwc

Earnings and returns

## Cash earnings[1]

+0.1% hoh
-0.9% pcp

$15.3bn

Cash earnings were flat during the first half at $15.3bn, with a slight decrease of 1% pcp. Strong growth in gross lending (excl. acquisitions) and a stable net interest margin (NIM) has seen net interest income (NII) grow ~2%. Operating expenses continued to weigh on results, while credit expenses and other operating income (OOI) were flat.

## Return on equity

+20 bps hoh
+1 bps pcp

11.2%

Return on equity (ROE) remained stable, with a 20 bps increase to 11.2%. This was attributable to a 2.7% increase in cash earnings (including acquisitions) and a modest 1% increase in average equity levels. Over the past three years, ROE has consistently hovered between 10.6% and 11.2%.

Revenues

## Net interest income[1,2]

+2.0% hoh
+2.5% pcp

$38bn

NII reached a new milestone, increasing to a record $38bn during 1H25, due to an overall growth in interest earning assets. The upward trajectory in NII, combined with an increase in lending volume facilitated a continued recovery of NIM since 1H24 (although noting the bounce back is slowing down since 2H24). As rates come down, volume/margin trade-offs will remain critical for banks in the outlook for NII.

## Other operating income[1,2]

-0.1% hoh
-4.8% pcp

$7.5bn

OOI decreased marginally to $7.5bn (albeit falling within our definition of "flat"). Banking fees remained the biggest contributor, with some variability in trading income among the banks.

Lending

## Net interest margin

-1 bps hoh
+1 bps pcp

1.8%

NIM was stable, decreasing 1bp hoh. While overall lending growth is up, as reflected in NII, competitive dynamics have put continued pressure on lending margins resulting in NIM reductions for this half. Competition for deposits is also evident as customers shift to products with higher interest rates. Contributions from capital, markets and treasury were variable across the banks.

## Lending growth[1]

+48 bps hoh
+296 bps pcp

5.1%

Lending has grown by 5%, up both hoh and yoy. This has been driven primarily by business lending (3.1% hoh), while mortgages grew at 2.3% hoh. Consumer lending has continued its decline, falling 17.7% hoh.

Expenses

## Operating expenses[1,2]

+2.0% hoh
+4.2% pcp

$22.2bn

Expenses increased once more due primarily to continued investments in technology, which rose 4.8% hoh to $4.2bn, and personnel, rising by 4.5% hoh to $13.2bn, (including acquisitions). Overall, excluding the impact of acquisitions, expenses rose by 2% to $22.2bn (while the impact of acquisition increased by 3.1%).

## Expense-to-income ratio[2]

-10 bps hoh
+123 bps pcp

48.6%

Expense-to-income (ETI) ratio was flat hoh, while increasing by 123 bps pcp. There has been a steady rise in ETI since 1H23, as the benefit to NII from rising interest rates has been replaced with fierce competition. Concurrently, expenses continue to rise steadily in response to inflationary pressures and investments in technology.

Asset quality

## Credit impairment expenses[1]

+3.1% hoh
-13.1% pcp

-$1.1bn

Credit impairment expenses were flat at just over $1bn (which excludes the impact of acquisitions). Impaired assets increased marginally as a proportion of gross loans, however provision levels (and impairment expense as a result) remained broadly flat as these loan losses were already anticipated. The loss rate decreased marginally by 2bps to 6bps, driven by gross loans and acceptances (GLAA) growing faster than credit impairment expenses.

## Credit provisions[1]

+1.2% hoh
+1.8% pcp

$21.7bn

Credit provisions were broadly flat both hoh and yoy. Comparing the level of credit provisions (including the impact of acquisitions) to gross impaired assets indicates that banks are able to withstand losses to cover the current impaired assets over 3 times (compared to 1.5 times back in 2018).

Balance sheet

## Credit provision cover[1]

-1 bps hoh
-2 bps pcp

65bps

The provision coverage ratio was down 2bps on the half, as provisions were flat and lending grew. Provision coverage has been within a range of 65 to 70bps since 1H22, however the mix of provisons has changed, with individual provisions as a proportion of total provisions trending up as stress begins to emerge in individual names.

## Core equity T1

-29 bps hoh
-57 bps pcp

12.1%

CET1 ratio decreased to 12.1% during this half. This represents a downwards trajectory of 29bps hoh. While CET1 levels continued to increase by ~1% hoh, RWA rose by 3.5%.

Westpac no longer report cash earnings and amounts included above are as reported on a statutory basis, without adjustment. Adjustments have been made for the impacts of the ANZ acquisition of Suncorp Bank where specifically noted.

1 excluding acquisitions
2 excluding notable items

# Executive summary

## 1 / Holding steady

Australia's major banks reported combined cash earnings (excluding the impact of acquisitions) of $15.3bn for the first half of 2025, which is marginally up from 2H24. Return on equity (ROE) for this half remained stable at 11.2% (with a slight increase of 20 bps). This is perhaps unsurprising given the increase in earnings (including acquisitions of 2.7%) and a modest 1% uptick in average equity levels.

Net interest income (NII) reached a record high of $38bn (excluding acquisitions), yet the net interest margin (NIM) continues to be under pressure, falling ~1bps half-on-half (hoh). Margin compressions were partially offset by loan growth which came in at 5.1% on an annualised basis (and approximately 4.9% if including the impact of acquisitions). It is also interesting to note that deposit funding (as a proportion of overall funding), is the highest it has been in nearly a decade.

In the first half, business lending has demonstrated continued growth, with an increase of 3.1%, surpassing slower growth in mortgage lending, at 2.3%. By contrast, consumer lending has continued to see run-off, with balances declining by 17.7%. Other operating income (OOI) decreased marginally to $7.5bn (excluding acquisitions).

A notable factor was the increase in operating expenses, which rose 2% in the current half and by 4.2% prior comparative period (pcp), excluding acquisitions. This increase is primarily driven by rising costs associated with technology and personnel, resulting in a cost-to-income (CTI) ratio of 48.6% (excluding notables). There has been a steady rise in CTI since 1H23, as the benefit to NII from rising interest rates has been replaced with fierce competition, inflationary pressures and investments in technology.

Signs of credit stress are continuing to emerge, as the growth in impaired assets (4.2% hoh) outpaces overall loan growth (2.4% hoh). The mix of provisions also reflect this, with individual provisions as a proportion of total provisions is also trending up (12% hoh). Notwithstanding this, total provisions and provision coverage were broadly flat as the increase in stress was anticipated and reflected in the provisions that were already held, as was credit impairment expense at $1.1bn. Banks continue to maintain robust provisioning against residual uncertainties, with total provisions covering 3 times the current impaired assets.

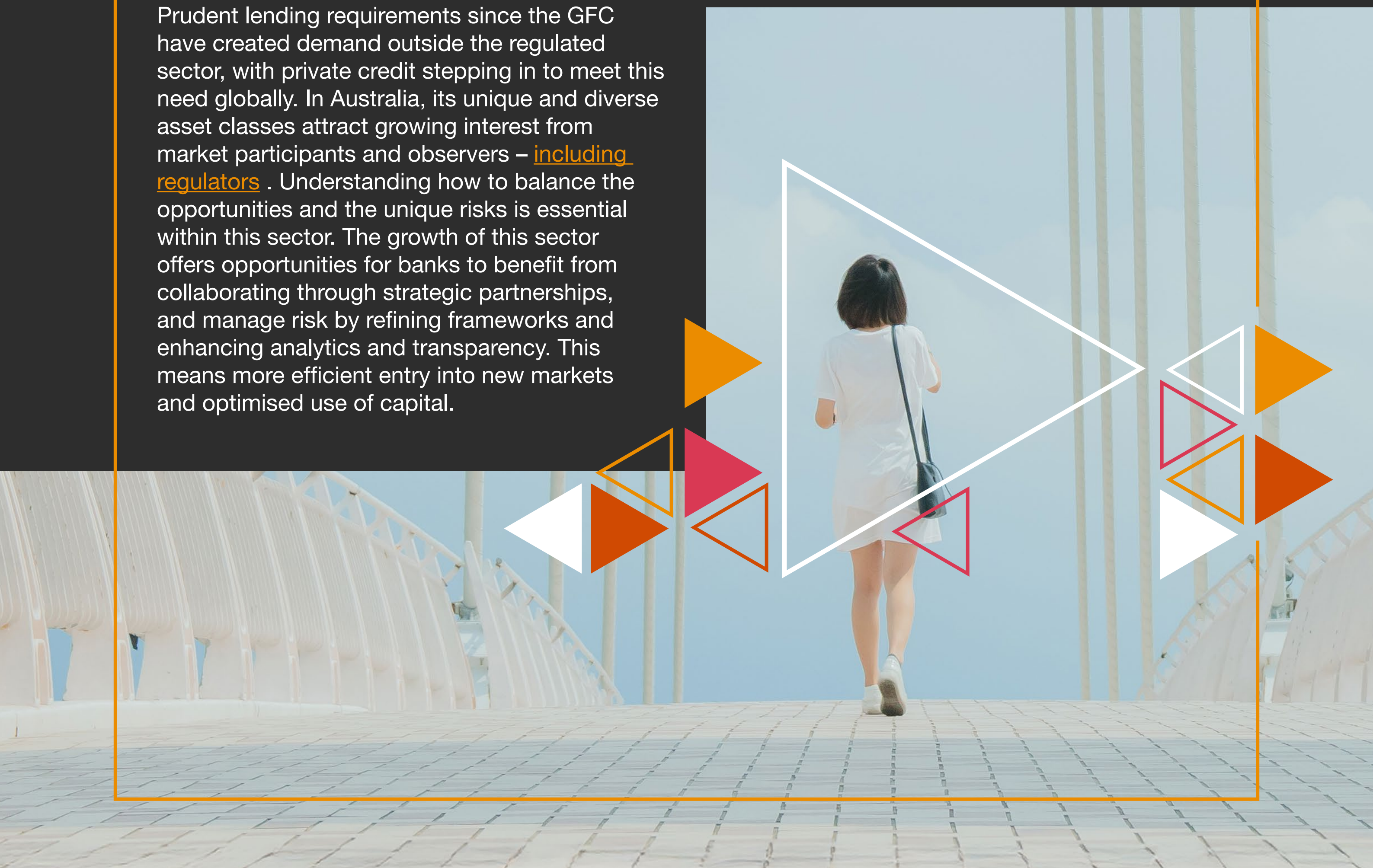
## 2 / Weighing up financial and operational priorities

Financial results don't occur in isolation. They are the result of a multitude of decisions that banks make every day. By analysing the latest half-year results from Australia's major banks, we've focussed on where banks have been channelling their energies – and what their next priorities may be. Several of those priorities could help to strike a balance between stability (i.e. financial and operational risk management) and agility (to adapt products to customer preferences and, capital and liquidity positions to global market volatility). The dramatic shifts in the geopolitical landscape largely occurred outside of the first half results, however regulatory guardrails to shore up capital and operational resilience are embedded or well underway. Australia's adoption of Basel III (maintaining world-leading capital standards) and CPS 230 Operational Risk Management appear prescient, with uncertainty hanging over the global economy. Strong levels of capital are crucial at a time when many prominent figures are suggesting a global recession could be on the horizon.

Prudent lending requirements since the GFC have created demand outside the regulated sector, with private credit stepping in to meet this need globally. In Australia, its unique and diverse asset classes attract growing interest from market participants and observers – including regulators . Understanding how to balance the opportunities and the unique risks is essential within this sector. The growth of this sector offers opportunities for banks to benefit from collaborating through strategic partnerships, and manage risk by refining frameworks and enhancing analytics and transparency. This means more efficient entry into new markets and optimised use of capital.

On the operational front, expenses in H1 are no doubt triggered by the breadth and scale of the technology transformation slate, encompassing regulatory change, technology modernisation and payments infrastructure changes. Each of the major banks are working on programs to simplify, modernise and digitise their technology and processes. These programs aim to deliver a lower operating cost base in the long run, but it takes years to fully achieve this. During any time of major technology transformation, operational risk is heightened. This operational risk is compounded by the potential financial impacts of a protracted higher cost base to run 'old' and 'new' technology in parallel until a program fully completes.

At this time of extended, heightened technology investment, execution discipline is a huge priority for executives. AI may offer transformation acceleration and productivity uplift. Although, again, a balance needs to be found – AI may offer an antidote to increasing costs, but also has introduced heightened cyber, fraud and scam threats – trust guardrails must be firmly put in place.



## 3 / Striking the right balance

Maintaining balance on unstable ground requires strength at the core and agility in the outer limbs to counterbalance and adapt. Australian banks are well on the way to achieving this posture by establishing strong core discipline and execution capability. It remains to be seen how banks globally will respond to the current market and geopolitical conditions, however it's certain that customer preferences and expectations will continue to evolve – driving the need for continuous innovation in customer experience and products.

Recent research by PwC[1] shows how new patterns are emerging in banking consumer preferences. These preferences offer important clues as to what the future state of products and services should deliver through technology and payments modernisation.

### 01 Increasing competition, but also an opportunity for retirement deposits

Younger consumers consistently indicate a higher propensity to switch banks, with 49% of under 50s having recently changed banks. Furthermore, Gen Z and Millennials are 50% more likely to consider non-banks for core banking services. On the flipside, the proportion of Australians over the age of 65 is forecast to continue steadily increasing, which makes superannuation releases an attractive opportunity for deposit growth.

### 02 Escaping the '<u>commodity trap</u>'

Australian banks have continued to compete head-to-head on price, especially in retail deposits and mortgages, however, cost was the third-ranked priority among consumer preferences for services. Customers ranked secure and trustworthy services above all; followed by convenience and responsive customer service. After 'cost' at third, personalisation of banking products is a close fourth. Additionally, among value-add services, consumers value fraud and identity protection, as well as loyalty programs. All of these adjunct services offer pathways for banks to differentiate outside of price alone.

1 PwC Global Consumer Preferences Survey: Banking

Amidst the current volatility, banks must maintain focus on their customers and evolving preferences. Notably, banks' ongoing technology and payments modernisation programs present an opportunity to balance investments in internal system modernisation with differentiated front-end experiences for bankers and customers – evolving products and experiences to gain much needed market share and compete beyond price.

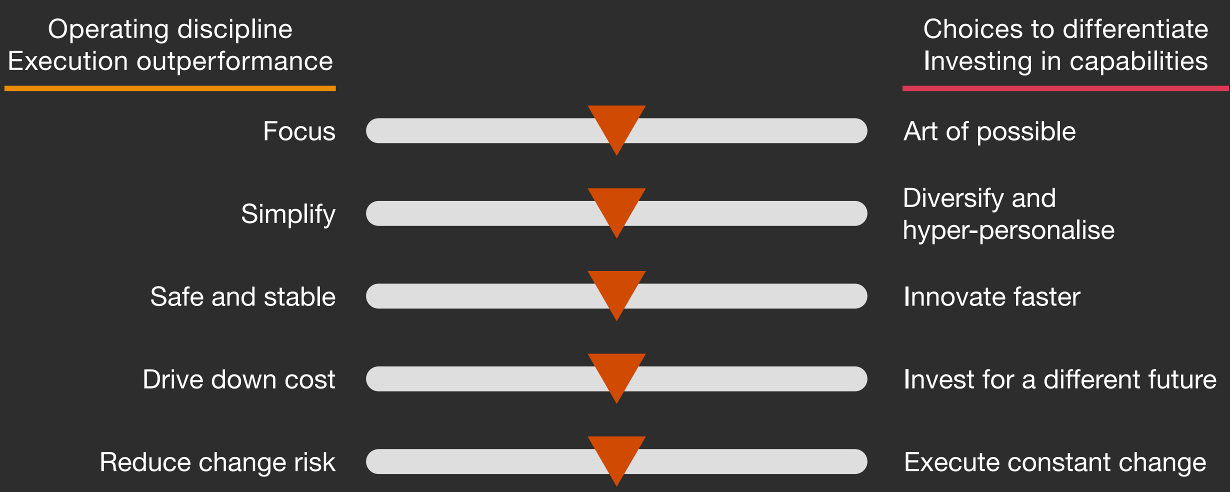
In our prior publications, we explored the strategic and mindset tensions banks are facing into. Amongst heightened volatility, the near-term focus may shift towards shoring up financial and operational discipline. However, technology advancements and customer preferences could bring the reinvention imperative sooner than banks expect.

PwC's recent Value in Motion research highlights the opportunity over the next 10 years. Value in Motion refers to the reconfiguration of the global economy, where value pools are moving from industries to domains, creating significant opportunities for companies to work across sector boundaries as they meet our fundamental human needs. Banks should be asking:

- What value pools should we be looking to access as business models are reinvented?
- What are the opportunities for us as our customers reinvent their business models to access these new value pools?

The future is more uncertain than ever, but the current half results for major banks shows they are facing into this future from a position of strong fundamentals. How to move forward? It's all a question of balance.

**Figure 1** **Striking the balance**



# 01

# Results holding steady, however continue to be squeezed by competitive pressures

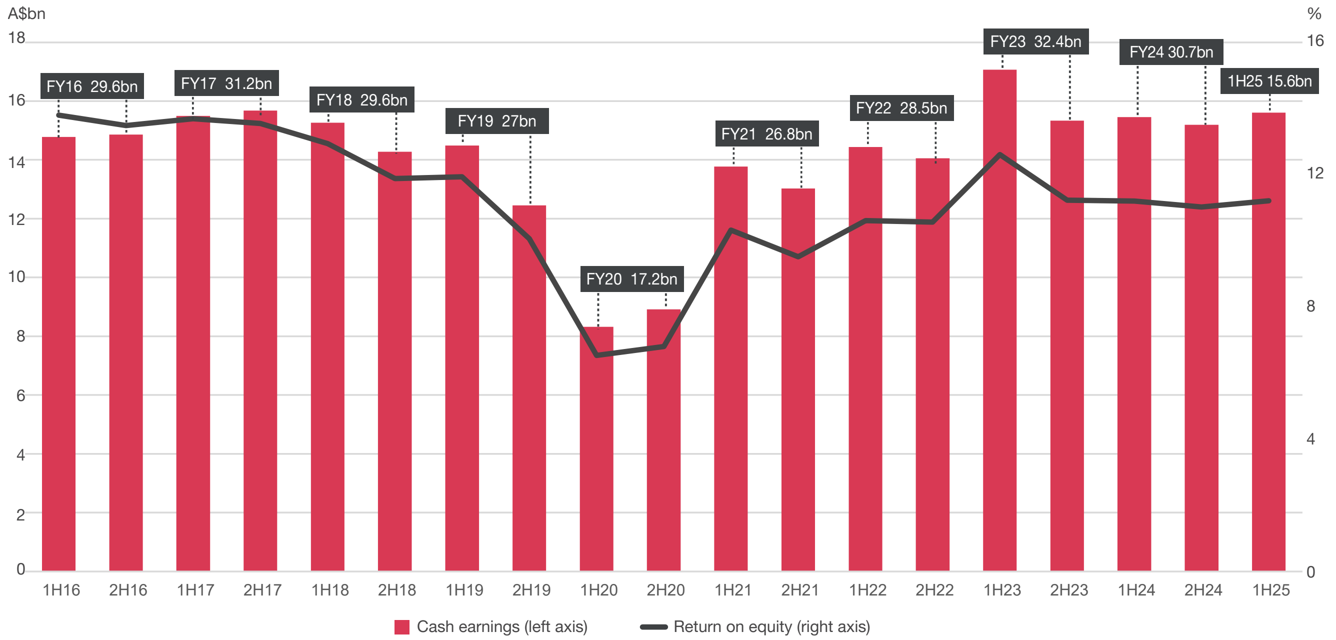
## Cash earnings and ROE remain stable

Australia's major banks reported combined cash earnings of $15.6bn (including acquisitions) for the first half of 2025, which increased from $15.2bn in 2H24. Excluding acquisitions, cash earnings were flat.

Lending growth was up, while NIM was broadly flat, resulting in NII reaching a new milestone, increasing to a record $38.6bn. This record was still hit even excluding the effect of acquisitions. OOI was flat at $7.7bn, while operating expenses continued to rise (2% hoh) and credit impairment expenses were flat.

ROE for this half remained stable at 11.2%, which is a 20 bps increase from 2H24. This increase was attributable to the 2.7% increase in cash earnings and a modest 1% increase in average equity levels. Over the past three years, ROE has consistently hovered between 10.6% and 12.6%.

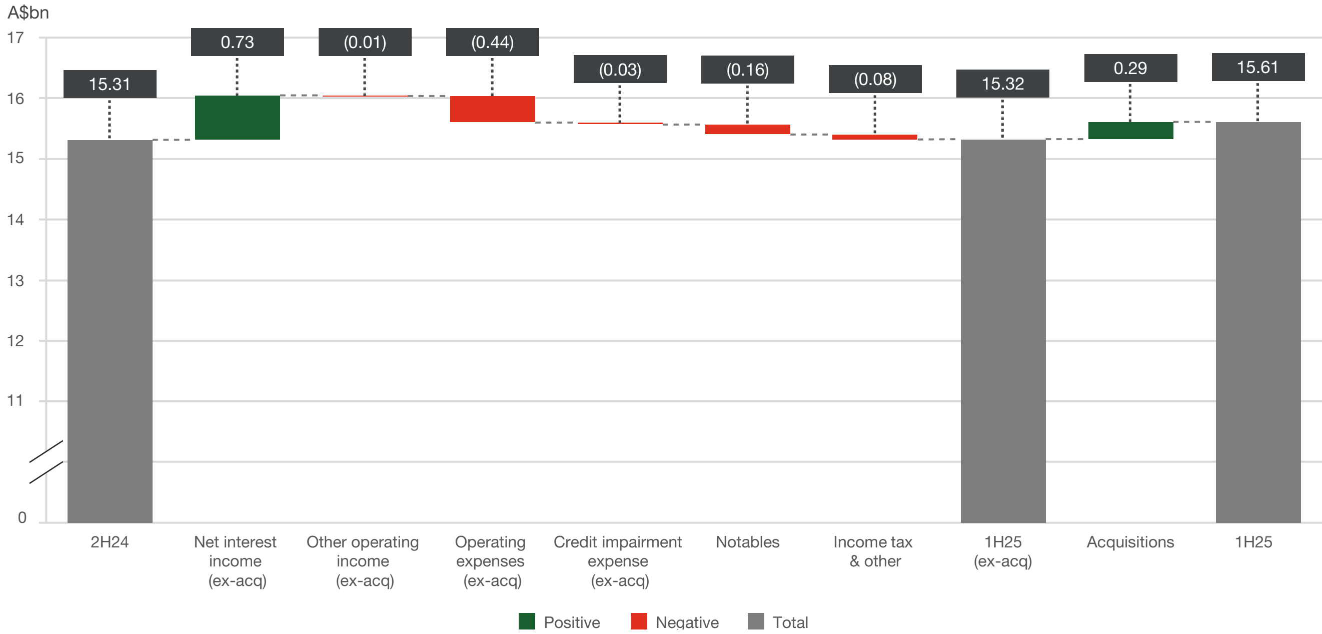
**Figure 2** **Earnings up including acquisitions, steady excluding, and ROE remains respectable at ~11%**




Source: Bank reports, PwC analysis

Looking at the movements in cash earnings more closely, NII increased on the prior period, driven by lending growth at relatively stable overall margins. This was offset mainly by increased operating expenses, while acquisitions added ~$290m to earnings overall – as shown in *Figure 3*. Credit impairment expenses were very similar to the prior half, as increases in impaired exposures were covered through a lower proportion of collective provisions, rather than increased impairment expense.

**Figure 3** **NII and acquisitions increases are offset by increased operating expenses.**



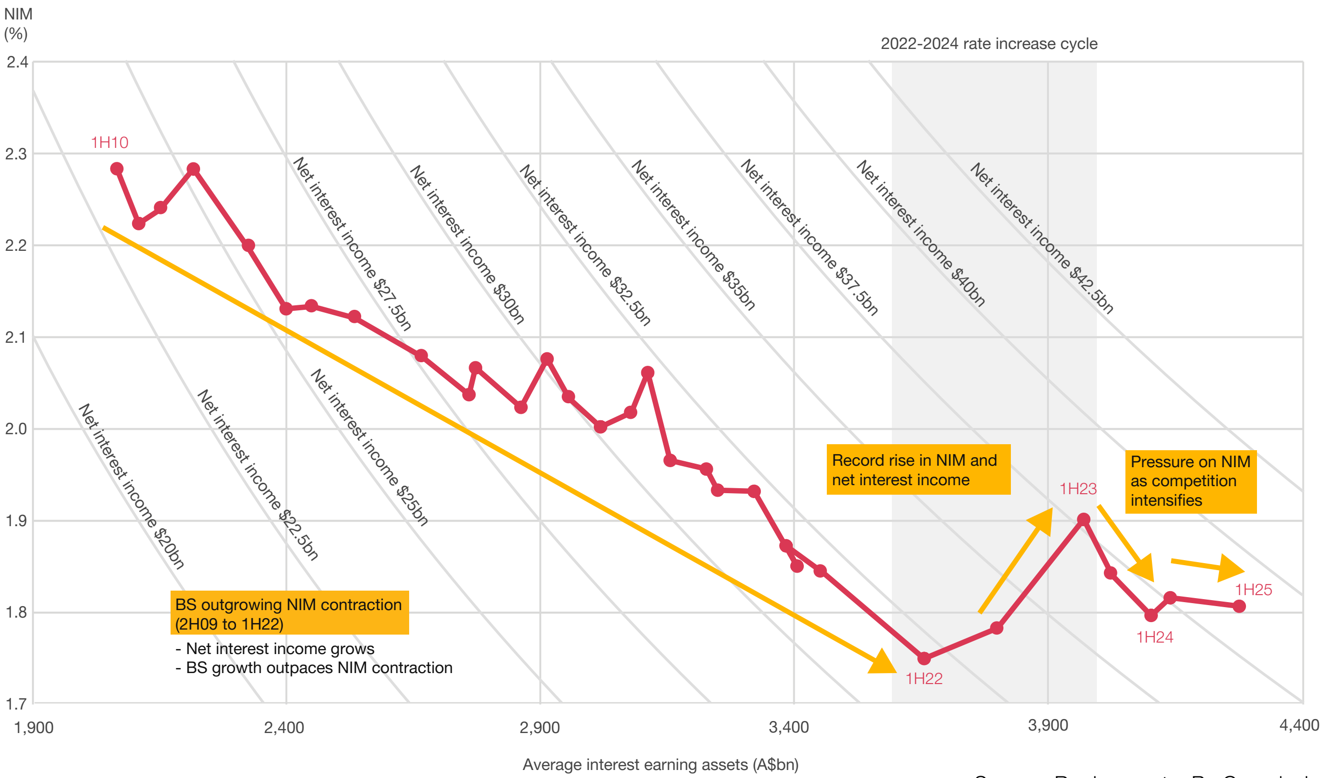

Source: Bank reports, PwC analysis

When analysing the change in NII over the year, *Figure 4* provides a useful way of assessing the intersection of the two key drivers – NIM and Average Interest Earning Assets (lending volume). The solid dots graph the majors over time and moves from 1H10 (top left) to 1H25 (bottom right) – with each dot showing the NIM for the half (y-axis) and the corresponding Average Interest Earning Assets (x-axis). This intersection on the x- and y- axis is the resulting NII for the half (denoted by the grey curves).

If we follow the points from top left to bottom right, we see the all too familiar picture of a consistent decrease in NIM (y-axis), however this has been more than offset by the increases in lending volumes (x-axis) – with the net result being a steady increase in NII over time despite a structural decline in NIM.

The Reserve Bank of Australia's most recent rate increase cycle from 2022 to 2024 boosted the NIM, reaching a peak in the first half of 2023. However, a steady decline followed. The slight increase in NIM achieved in 1H24 was partially reversed in the first half of 2025, with competition in lending and deposits contributing to a 1 basis point decrease in NIM – continuing the longer term downward pressure on NIM.

**Figure 4** **Record NII in 1H25 – driven by volume growth**



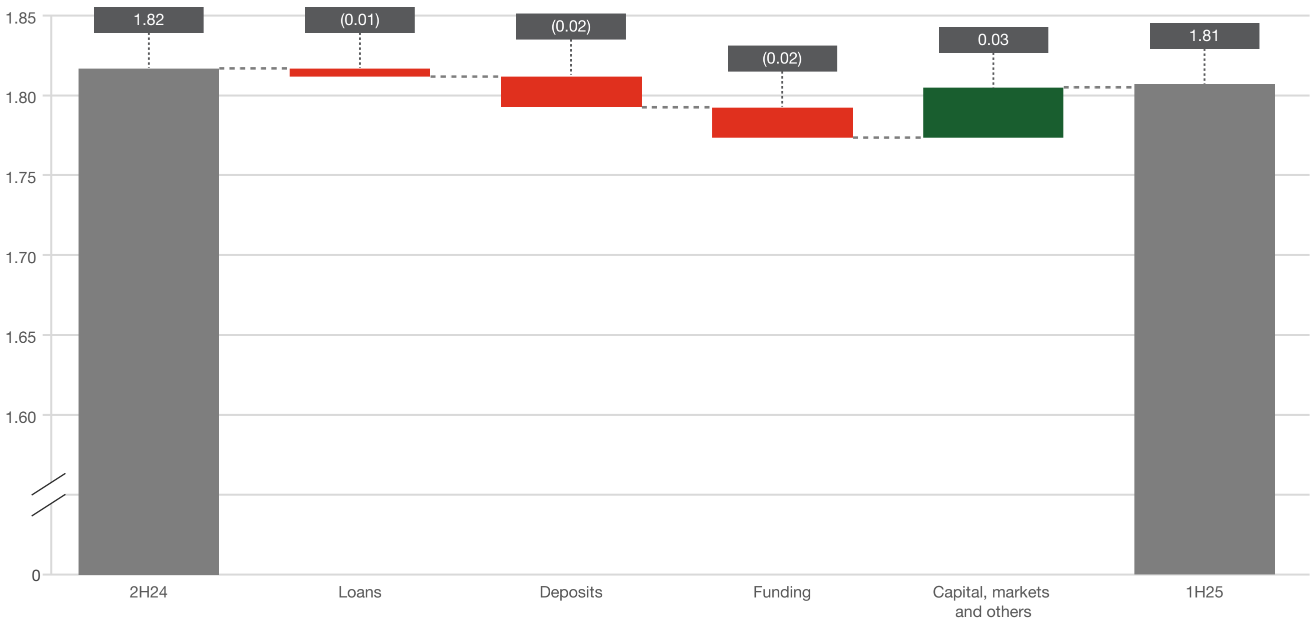

Source: Bank reports, PwC analysis

*Figure 5* breaks NIM apart into its key drivers. Deposit pricing was a key theme this half, reducing NIM by 2bps, driven by competition, as well as a shift in mix towards higher rate products. Similarly, increased wholesale funding costs also reduced NIM by 2bps.

The impact of competition in Business Lending and Mortgages – while only leading to a 1bp reduction in NIM, was also called out consistently this half. We also observed emphasis on the balance between volume and margin in the mortgage book, as well as efforts to grow the proprietary origination channel, in an effort to stabilise or grow mortgage NIM into future periods.

The key accretive change during the year was an increase yield on the banks' capital investments and other items – however this was not enough to offset the other declines.

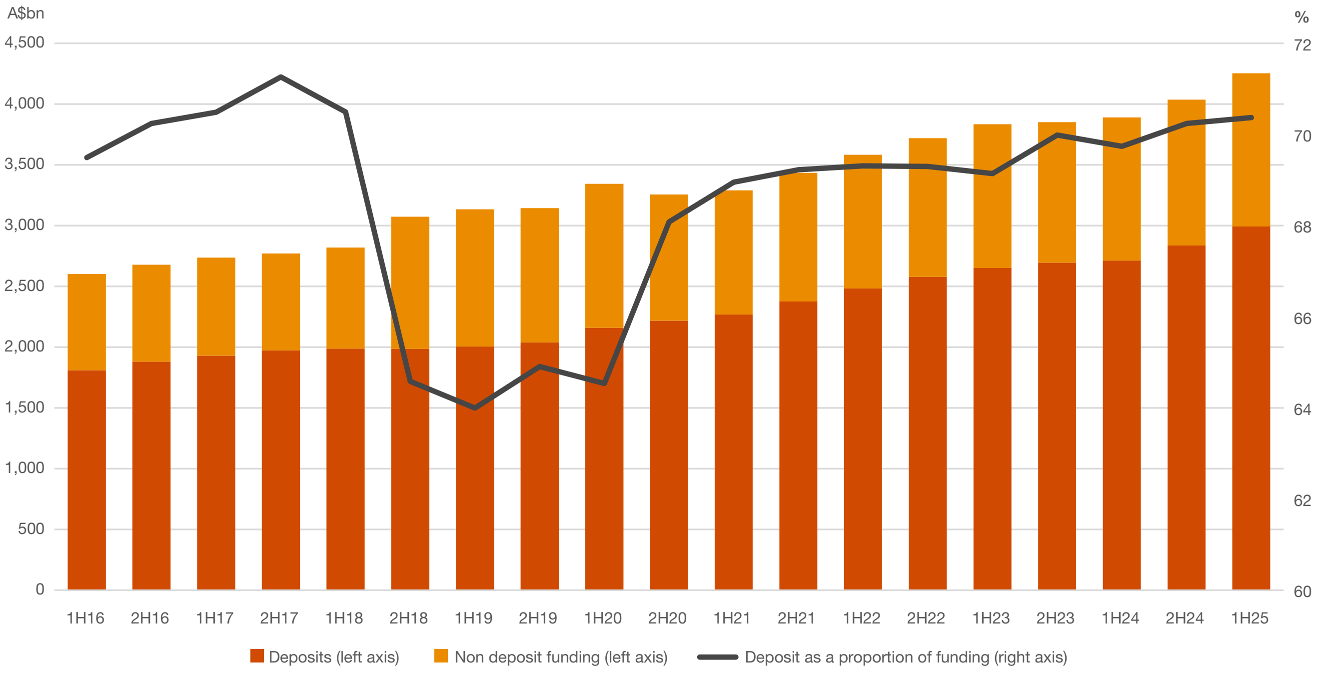
**Figure 5** **Core lending NIM continues to decrease, driven by deposits and funding costs**




Source: Bank reports, PwC analysis

Deposit growth was strong this half, growing close to 6%. The proportion of deposit funding as part of the banks' overall funding mix is nearing its highest point in the past decade. The higher deposit funding reliance reduces the need of the majors to rely on more expensive wholesale funding, however as rates fall ongoing price competition or product switching may continue as customers search for higher interest rates.

**Figure 6** **Deposits as a proportion of funding is at its highest point in nearly a decade**



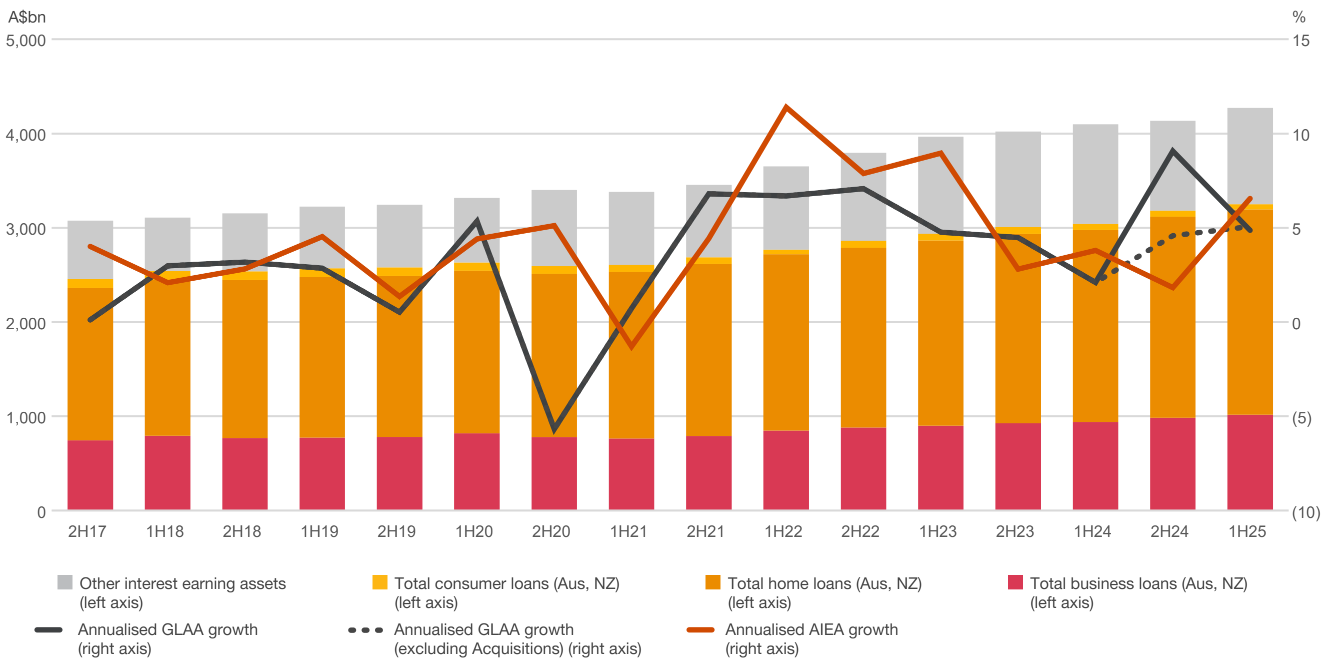

Source: Bank reports, PwC analysis

## Lending growth for the majors is up in the first half, to the highest level in 2 years

*Figure 7* shows the increase in Gross Loans and Advances (GLAA) and Average Interest Earning Assets (AIEA), both of which saw the growth for the major banks improve during 1H25 (excl acquisitions).

Business lending growth continued to be higher than mortgages this half, with growth at 3.1% half-on-half, as compared to 2.3% for home loans. Consumer finance continued to run-off with a -17.7% drop half-on-half. With strong competition in the mortgage market and more attractive margins, business lending continues to be the natural segment to focus on in the current environment, with sustained focus in the strategy of the majors, and supported by ongoing investment.

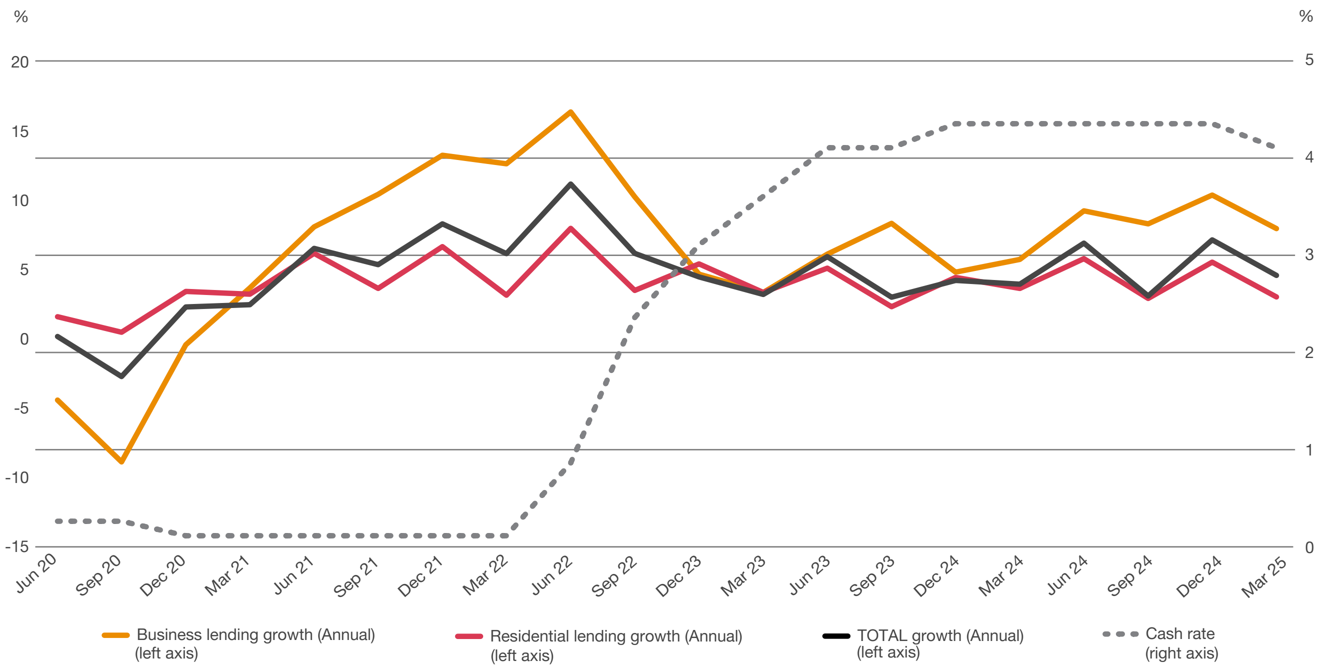
**Figure 7** **GLAA growth picks up in 1H25 – coinciding with a reduction in the cash rate during 1H25**




Source: Bank reports, PwC analysis

Looking only at Australian loans, *Figure 8* highlights the notable divergence we continue to see between business and residential loan book growth for the majors, based on data from the Australian Prudential Regulation Authority's (APRA) monthly statistics. Business lending continues to be the key driver of growth, as mortgage growth remains relatively stable.

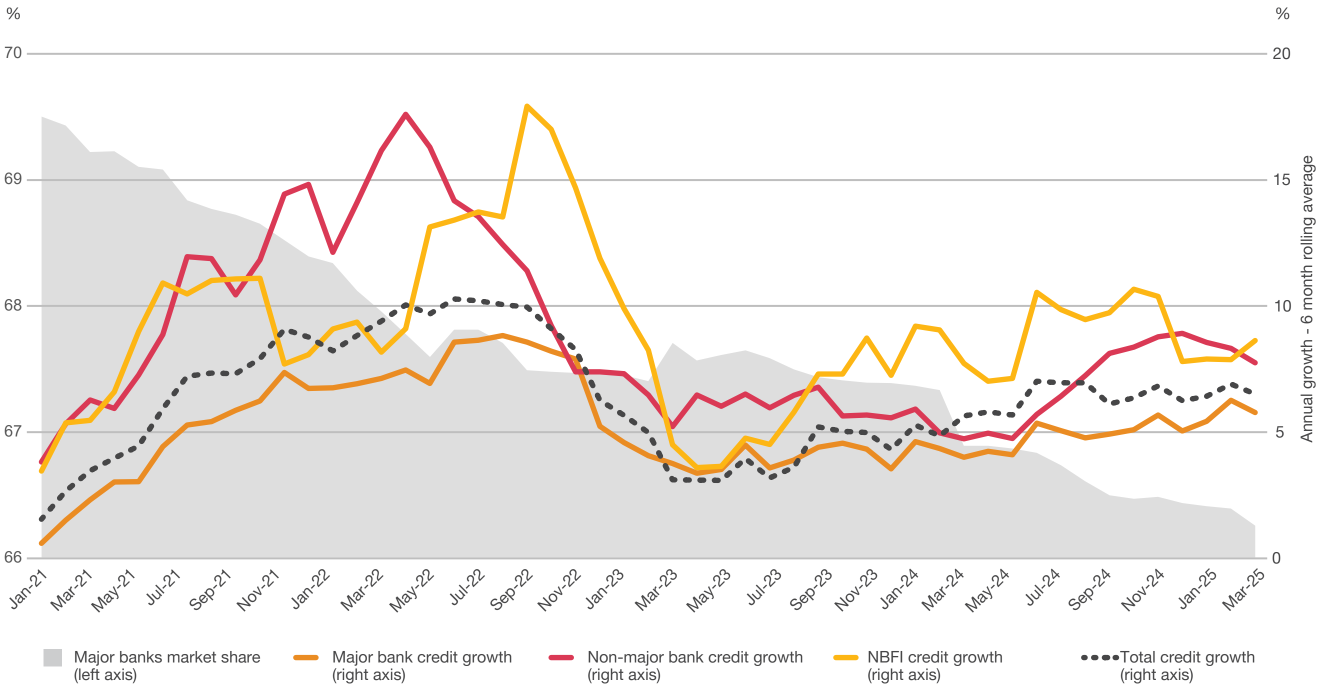
**Figure 8** **Business lending growth for the major banks continues to outperform residential, a trend since 1H23**




Source: APRA Monthly Banking Statistics, RBA Cash Rate Target, PwC analysis

Continuing the focus on Australia only lending, the majors have experienced slower than overall system loan growth – the total system grew at an annualised average rate of 6.5%, while the majors showed growth of 5.7%. *Figure 9* shows the impact this has had on the majors market share, which has continued its downward trend to 66.3%. Statistics released by APRA outline that both non-majors and NBFIs continue to take this share growing at 7.7% and 8.6% (on an annualised basis) respectively.

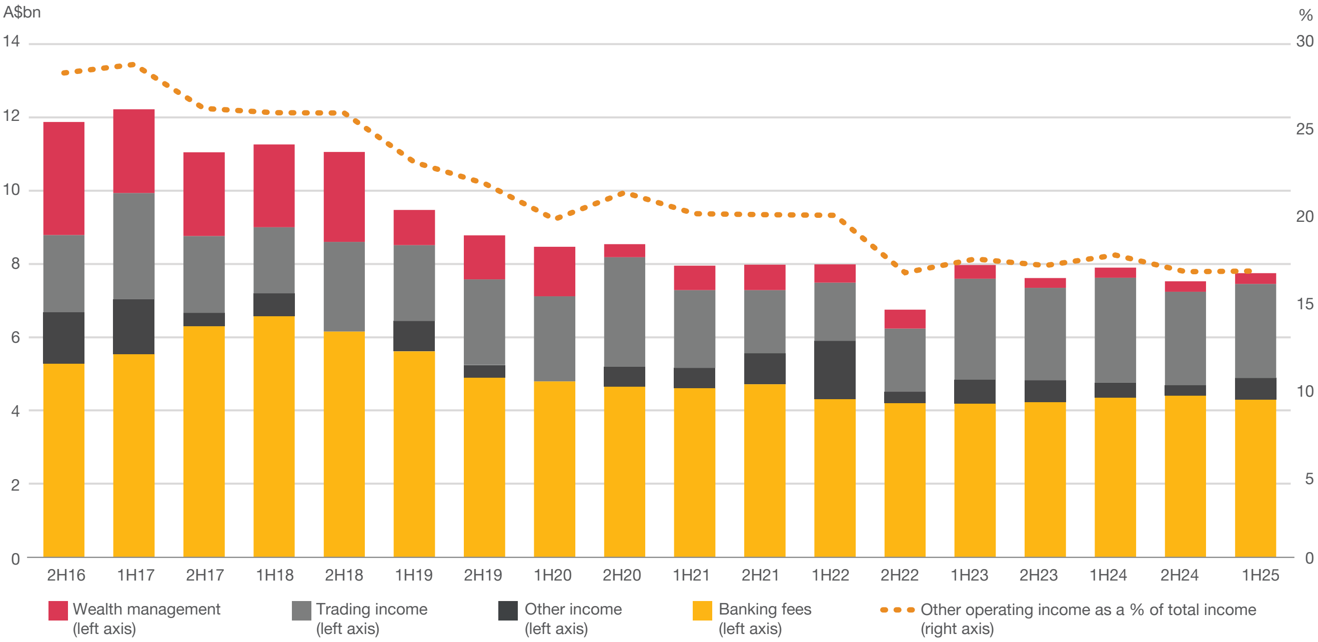
**Figure 9** **Majors' market share continues to decline**




Source: APRA Monthly Banking Statistics, RBA Financial Aggregates Statistics, PwC analysis

Outside of interest income, 1H25 saw an increase in OOI in absolute terms while remaining flat as a percentage of total income, as shown in *Figure 10*. However, looking at the period-on-period movement, the contribution from OOI declined both in absolute terms and as a percentage of total income. Banking fees (which is the largest income type by size) saw a 2.3% decrease in the half, although it was offset by increases in wealth management and income from other banking sources.

**Figure 10** **OOI as a percentage of total income has remained flat in the half**



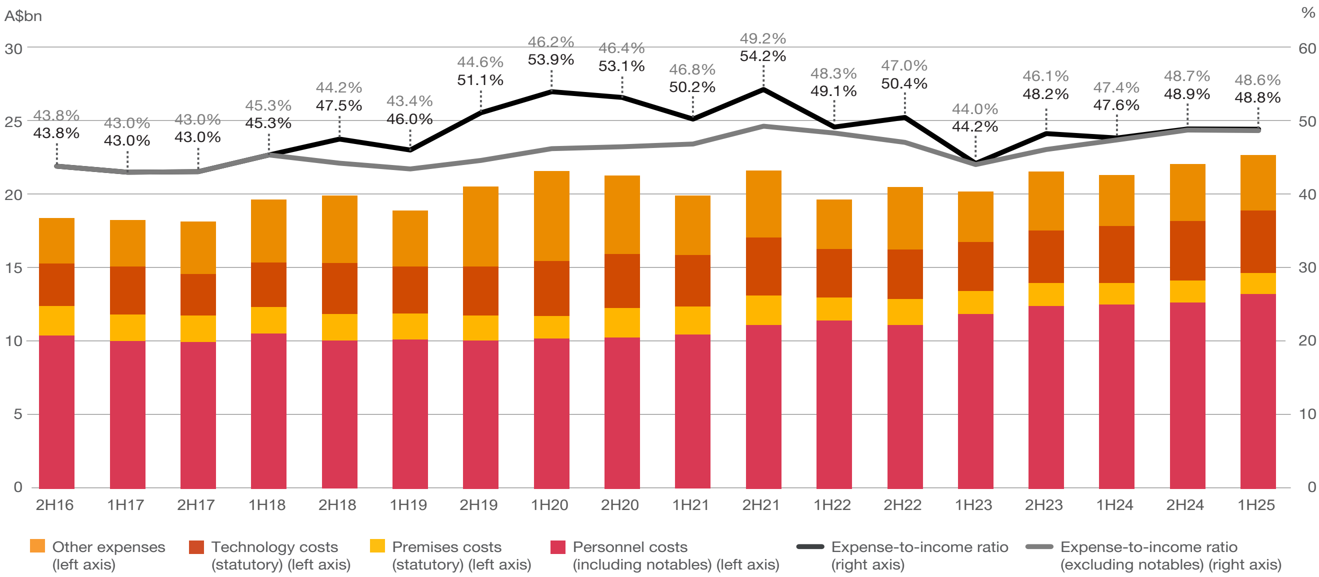

Source: Bank reports, PwC analysis

## New peak for total operating expenses as inflation and investment continue to bite

Operating expenses continue to climb, reaching $22.6bn, a peak not seen in the past decade. This 2.7% rise in the operating expenses (including notables) from the prior half-year tells a story of growing costs, with personnel expenses (4.5% / $0.6bn increase half-on-half), leading the charge as the substantial driver, alongside technology (4.8% / $0.2bn increase half-on-half), noting the first half is typically lower due to seasonality.

Yet, the expense-to-income ratio was steady at 48.6% (excluding notables), painting a picture of balance amid the shifting tides. While income has grown, fuelled by robust lending, the parallel rise in personnel and technological costs has kept pace, tempering the gains. This interplay illustrates the broader industry shift as banks strive to balance cost structures while investing in digital capabilities and human capital.

**Figure 11** **Operating expense hit a record high, with continued increases in technology spend**

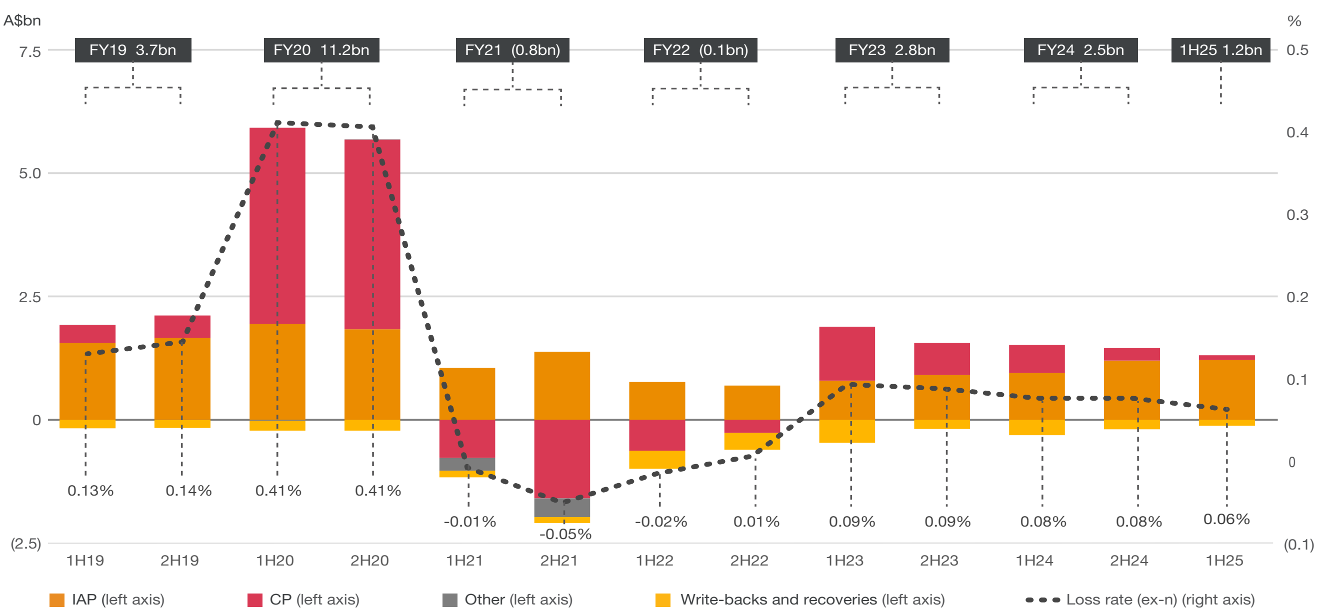



Source: Bank reports, PwC analysis

## Credit expenses down slightly as provision coverage remain stable

Credit expenses were just over $1bn for the first half. In a climate of uncertainty, the value of write-backs and recoveries has declined during the half by around 39%, however, the loss rate excluding notable items decreased by 2bps, as GLAA grew more than credit impairment expenses. Funding for individual provisions has increased slightly, continuing the upward trend from the last half, while collective provision funding has declined by 64% since 2H24. Overall, new provision funding has been benign and loss rates low since 1H23. This is following the uptake of provisions in 2020 during the pandemic and their subsequent unwind through to the end of 2022. For comparison, provision coverage of gross loans (shown in *Figure 13* below) is 5bps higher (65bps) this quarter when compared to 2H19 (60bps).

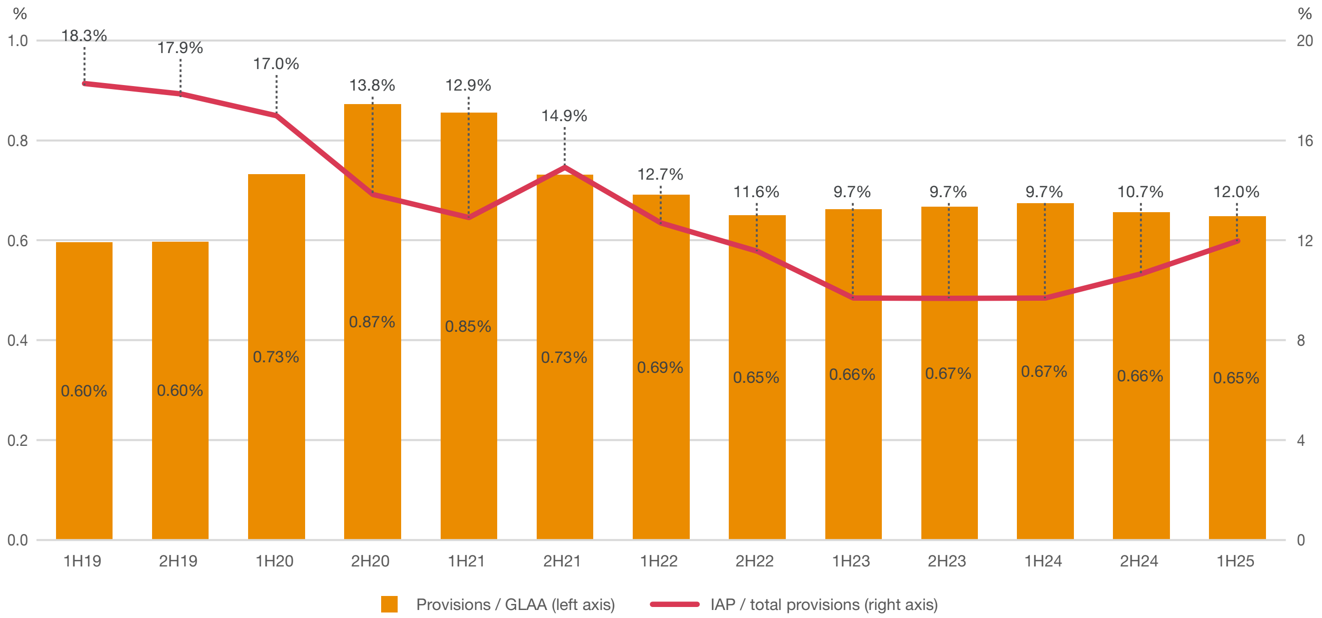
**Figure 12** GLAA growth outpaces credit impairment expense




Source: Bank reports, PwC analysis

Impaired assets as a proportion of gross loans has increased as shown in *Figure 13* below, however this was through a change in provision mix rather than an increase in new provisions. This, in combination with normal growth in the provision, matching growth in the portfolio, meant that provision coverage remained stable half-on-half.

**Figure 13** **Credit provisioning remaining stable, with increases in individually assessed provisions**




Source: Bank reports, PwC analysis

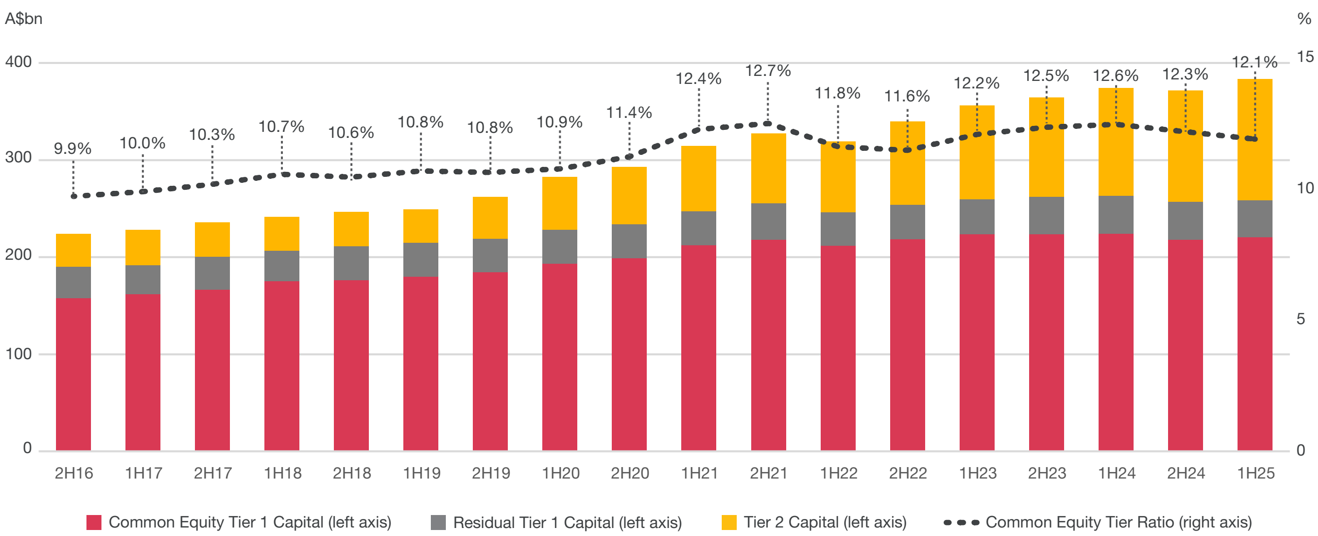
## Capital levels remain at healthy levels

Total capital rose by 3.2% to $383.6bn (including acquisitions) this half. The key drivers of this growth were the increase in Tier 2 (T2) capital of $10.3bn and an increase of $2.4bn in Common Equity Tier 1 (CET1) capital. While capital levels remained strong, risk weighted assets (RWA) rose by 3.5%, resulting in a drop in average CET1 ratio to 12.1% during this half, falling 29bps.

As confirmed by APRA, Additional Tier 1 (AT1) hybrid instruments will be phased out from 1 January 2027 to improve the effectiveness of a bank's capital in a stress scenario or crisis. As explained by APRA, this change will be replaced with an increase in Tier 2 notes and a marginal increase in CET1 capital. Relative to AT1 instruments, Tier 2 notes typically require a lower return with CET1 capital having a marginally higher return – so on balance the impact to earnings over the medium term should be flat.

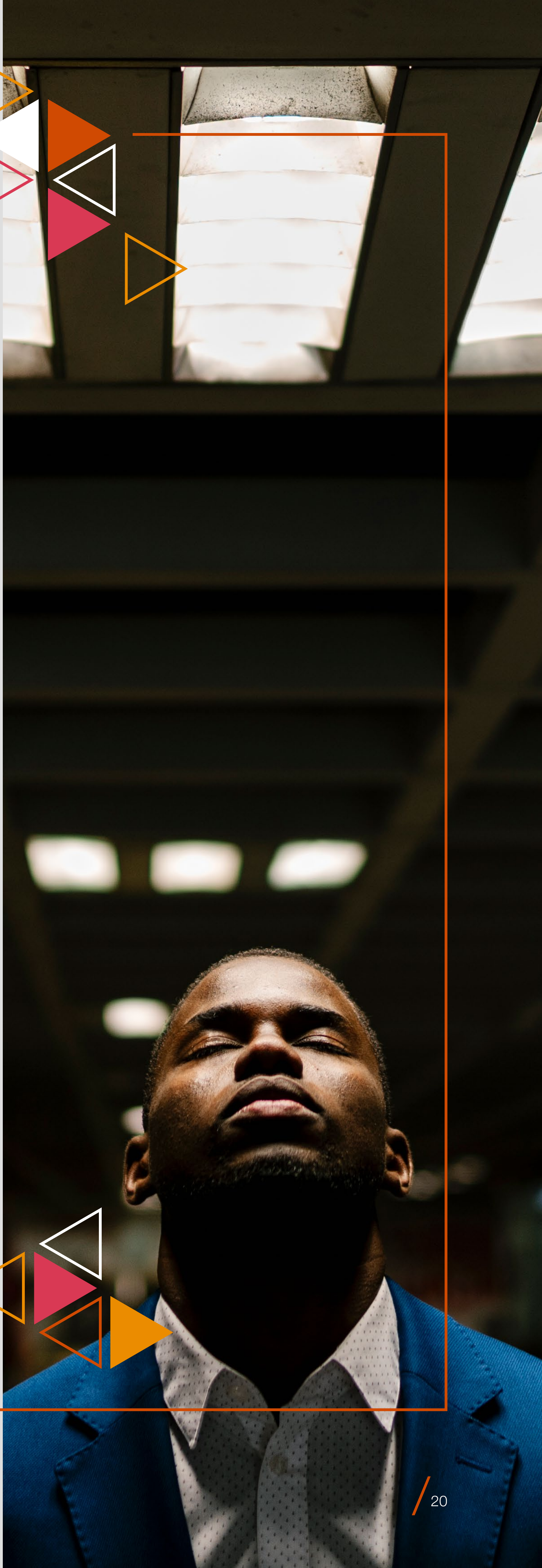
Further discussion around the trends that are impacting capital, such as Australia's early adoption of Basel 3.1 and focus on deregulation globally, and what this could mean for Australian banks is outlined in Section 2.1 below.

**Figure 14** **Capital levels up from 2H24, with a decrease in CET1 capital ratio**




Source: Bank reports, PwC analysis

# 02 Questions of balance



## 1 / Capital

### Unquestionably strong foundations provide stability in uncertain times

Australia's banking system has served the country well over the long term, enabling sustained investment that has fuelled economic growth. With the Australian major banks being the first to implement Basel 3.1 capital reforms globally, our capital ratios continue to be at the higher end of global peers, highlighting the robustness of the system.

As noted by several of the banks at 1H25, the level of economic uncertainty has increased. In these uncertain times, our banks are well prepared should future challenges arise.The regulatory approach is a balancing act – balancing strength and stability so we can continue to attract investment, with the ability to grow, and an overall objective of producing strong and stable earnings. There is clear confidence in the Australian banks reflecting this sustained stance.

In recent months, we have seen a discernible shift underway particularly in the US and the UK, with governments and industry bodies increasingly advocating for deregulation broadly – covering compliance simplification as well as capital and liquidity rules. This is primarily to boost the competitiveness of their banks and stimulate economic growth through increased lending and investment and removing some areas of friction.

The banking sector in these markets is intertwined – with UK and US banks competing fiercely in each other's markets. Australian banks are more domestically focused, which buys us some time to understand the nature of deregulation offshore, what is changed, and to study what works and what does not.

**What are we seeing?**

Regulatory settings inevitably shape market activity. Tighter bank regulations since the GFC have made certain types of lending less economical for traditional banks. Capital is expensive for banks to hold, and higher capital requirements for certain lending increases overall funding costs. The impact of this is that certain types of lending migrate outside of the banking system, creating opportunities for non-bank lenders and private credit funds (see the next section that explores the growth of private credit).

Outside Australia, tighter regulation has also begun to foster some financial innovation as institutions seek to optimise returns. For instance, we have seen transactions designed to tranche and transfer credit risk, known as synthetic risk transfers (SRTs), steadily increase in Europe and more recently in the US. SRTs allow banks to achieve capital relief by transferring the risk (and potential return) of specific loan pools to investors (often non-banks or private funds seeking yield). While SRTs are not yet a dominant feature of the local market, and lessons from the GFC remain relatively fresh, their development warrants monitoring, especially given the ongoing search for yield and that these transactions facilitate the transfer of risk into private markets, and the feedback loops are less well known. However, the prominence of these instruments could be tempered if the deregulation efforts overseas gain significant traction.

**What does this mean for banks in Australia?**

Given Australia's current conservative macroprudential posture, we would not expect a significant shift towards deregulation in the near term, instead taking an approach that carefully considers the results of these efforts overseas, while maintaining a stance that ensures Australia's economic goals are met.

Maintaining this focus on strength necessitates Australian banks tackle some of the more challenging aspects of their operations – specifically, reducing their cost to serve, product innovation and business model reinvention.

Banks will have a significant opportunity over the next 10 years – outlined in PwC's recent Value in Motion research. Value in Motion refers to the reconfiguration of the global economy, where value pools are moving from industries to domains, creating significant opportunities for companies to work across sector boundaries as they meet our fundamental human needs. Banks should be asking:

- What value pools should we be looking to access as business models are reinvented?
- What are the opportunities for us as our customers reinvent their business models to access these new value pools?

Tackling these challenging issues now offers more upside should appropriate deregulation opportunities emerge in the future.

Beyond addressing these hard structural challenges, we anticipate continued investment in business lending, though banks must diligently manage competitive pressures to avoid eroding margins. Deepening customer relationships and diversifying product mix remains crucial. Business lending has been a prominent topic for some time with competition intensifying – are the first signs of the commodity trap emerging in Business Lending?

## 2 / Private credit

### Balancing investor and borrower demands

In today's uncertain financial environment, the private credit sector is emerging as a practical solution to lending needs unmet by incumbent, financing entities constrained by certain regulatory requirements. This gap has allowed private credit to evolve as a dynamic and integral part of the financial landscape, offering flexibility that aligns with both investor and borrower needs.

As private credit gains traction globally, and more recently in Australia, its unique and diverse asset class exposure attracts increased interest from market participants and observers. Understanding how to balance the opportunities and the unique risks is essential within this sector.

**Demystifying private credit**

In its simplest form, private credit involves tapping into private sources of capital to lend to a borrower with the aim of earning a return on the capital deployed. Put simply, it is private lending.

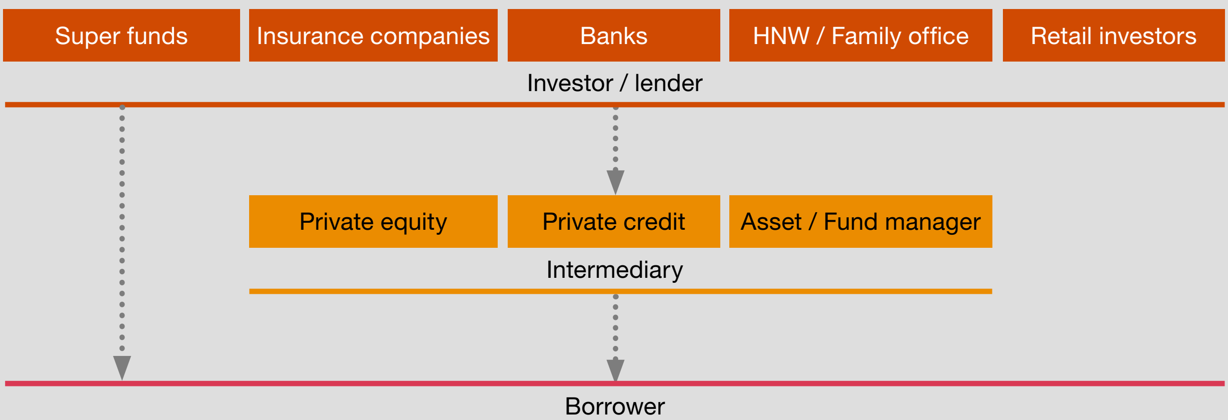
Private credit offers several advantages for borrowers, including faster approval times, greater access to loans—even for unconventional needs—and the ability to tailor lending solutions to meet specific borrower requirements. Concurrently, private credit is attractive to investors as it offers higher yields, better alignment between liquidity and investment horizons, and diversified investment options that were previously difficult to access.

Initially, private credit primarily involved distressed debt, where banks sought to offload into the private markets that have appetite for higher risks and returns. Over time, the scope of private credit has significantly broadened to include performing lending. This expansion encompasses various investment strategies, including direct lending, real estate debt, infrastructure debt and investment funds, serving both wholesale and consumer markets in listed and unlisted forms. Furthermore, private credit offers the opportunity to invest in debt with equity-like returns.

**How is the private credit ecosystem interconnected?**

The most complex risk with private credit—hard to measure and manage—is the broader systemic risk, given the interconnectivity and opacity of the private credit ecosystem. A simplified private credit value chain is illustrated below, but the reality is that the ecosystem is highly interconnected. Risks are not simply transferred but instead pervade across the system. That, in our view, provides both opportunities and risks that need to be balanced.

**Figure 15** A simplified private credit ecosystem



**What are the emerging risks, and how can they be addressed?**

Recent trends in private credit funds show newer fund structures incorporating redemption features, allowing investors more flexibility in withdrawing their investments. This represents a shift towards greater agility for investors. However, these features haven't been tested during financial downturns, raising concerns about liquidity.

Unlike stocks and bonds traded on public markets with clear pricing, private credit investments don't have easily observable market prices. This lack of transparency complicates the valuation process, affecting financial reporting and making it harder for investors to make informed decisions. Funds must strive for accurate valuation methods to maintain investor confidence. Moreover, potential conflicts of interest may arise within private credit funds, especially concerning fee structures and the ability to sell assets between different investment vehicles, which can destabilise fund integrity. Ensuring transparency and fairness is key to maintaining stability while providing the agility needed to adapt to market changes.

Finally, the complex architecture of the private credit ecosystem introduces indirect credit risks. The intricacy and inherent lack of transparency within the system can mask underlying vulnerabilities, posing challenges for investors (including major banks) and fund managers in accurately identifying and addressing these risks. Investors need to be particularly diligent in assessing risks and conducting thorough due diligence before committing to these types of investments.

As private credit continues to grow, it may be prudent to explore:

01 **Liquidity assessment**

How robust are the redemption features in newer fund structures during financial downturns, and what contingency plans do funds and investors have in place to manage liquidity risks effectively?

02 **Valuation transparency**

What steps can be taken to improve transparency in the valuation process of private credit investments, and how can participants ensure the accuracy and reliability of these valuations to foster investor confidence?

03 **Risk management strategies**

How can investors and fund managers effectively identify and address indirect credit risks and potential conflicts of interest within the complex private credit ecosystem to maintain both stability and agility in their investment strategies?

**What are the balanced opportunities for banks?**

To capitalise on opportunities within the growing private credit market while managing risks, considering these questions may be helpful in the short term:

01 Will embracing strategic partnerships and collaborating with financial institutions and fintechs allow banks to share resources and diversify exposure without straining capital reserves, enabling efficient entry into new market segments?

02 Does the bank’s technology roadmap consider data analytics and reporting efficiency, aiding in transparency and risk management as banks scale their lending activities specifically for the unique nature of private credit?

03 Have risk management frameworks (and risk appetite) been tailored to help banks navigate private credit complexities, optimising returns and enhancing investor confidence?

As private credit continues to be a topic of discussion in board rooms or coffee meetings, we can expect to see evolution in this sector as investors optimise the balance between managing the opaque risks within the ecosystem while capitalising on the opportunities to expand their horizons in this space.

## 3 / Technology

### Investing in resilient technology and operations – enabling agility to focus on customer-centred outcomes

Many major bank core ledgers (for deposits, lending, mortgages or cards) were first deployed 30+ years ago, and while the channels and products have evolved, in some cases, the primary architecture remains unchanged. This is for good reason – the legacy core systems have steadily handled ever-increasing volumes and velocity, and the risks of disruption to the bank's system of record and to customers in large-scale migrations often outweighed potential modernisation benefits.

However, major banks have reached an inflection point and modernising core ledgers is now high on the agenda for several reasons. Banks need to maintain supportability of systems, reduce key person risk, minimise operating expenses and simplify operations.

**What throws technology modernisation off balance?**

The difficulty of modernisation is exacerbated for major banks by the age of legacy systems, the volume of customers, the complexity of operations and products, and the fact that each bank serves a broad spectrum of customers, whose banking patterns must continue to be met (or face a major change management exercise at scale). Major banks cannot 'pick and choose' customers based on demographics or behavioural patterns, such as digital natives that only interact via an app. Society depends on our major banks to serve everyone, including non-digital customers and those with complex servicing needs – therefore, to truly modernise, these customers must also be catered for, and brought along on the modernisation journey.

Further driving the need for front-end agility are evolving customer preferences. The focus on simplification cannot be at the expense of product agility. In fact, PwC's research on consumer preferences shows that younger demographics see value in personalised products, as well as adjacent services such as enhanced identity and fraud protection, and loyalty programs.[1]

In many cases, technology transformation to date has been focussed on lower risk systems. For example, in the past decade banks have progressively migrated applications from on-premises data centres to cloud-based architecture, with the aim of both modernising infrastructure and removing the facility costs of data centres. However, as the footprint of systems remaining on-premises dwindles to only those that were initially perceived as 'too risky' to touch, banks must face into how to efficiently, safely and completely migrate or replace these systems. When modernising systems that carry higher inherent risk (e.g. core ledgers), banks to date have typically approached this by standing up a new ledger for new customers/contracts while their legacy customers remain on legacy systems.

This leaves banks with one foot in the old world, and one foot in the new.

This balancing act is becoming harder all the time. Banks risk incurring rising costs to maintain legacy systems alongside their new platforms, resulting in inflated operating expenses across technology licences, physical data centres and specialised support teams – also weighing them down with increased operational risk.

In short, major banks cannot reap the benefits of modernisation until legacy ledgers are fully decommissioned and customers migrated to the new systems.

**How can banks put technology on a steadier footing?**

The following success factors will expedite technology modernisation programs:

- **Simplify process and product in the legacy estate** to reduce complexity for the majority of customers (and ring-fence the long tail of products to be run-off or restructured), as well as readying customers for migration
- **Deploy best practice architecture and engineering practices** to lower operating costs, enhance resilience and increase agility in the new systems
- **Carefully consider the opportunities presented by AI** during and after the transformation

1 PwC Global Consumer Preferences Survey: Banking


**In the short term, how can AI accelerate our technology modernisation?**

Since the capability of generative AI and large language models ramped up in 2023, technologists have grappled with what AI means to their strategy in terms of both roadmaps and workforce. Whether you're of the 'Artificial General Intelligence' vs 'Normal Technology' view, there is an undeniable opportunity for productivity gains and a fundamental rethink in how and what is delivered in a technology transformation.

The potential for change is so great that it is hard to predict what a reasonable 5–10 year technology roadmap looks like, let alone estimate costs with any certainty. But in the near term, banks undertaking legacy modernisation should pursue opportunities to accelerate delivery, uplift quality and reduce the risk of disruption using the capabilities of AI, automation and agents alongside human specialists.

Key questions for consideration:

01 What is the impact to my workforce model in the next 6, 12 and 18 months? Does headcount continue to increase, hold or decrease?

02 What is a reasonable period of certainty to commit to in the technology roadmap? Those systems with very set and structured inputs and outputs may retain the same requirements. However, those processes and systems that handle unstructured data, natural language or context-heavy decisions may benefit from leveraging advancements in AI.

03 How does AI trust and alignment by design become incorporated into governance practices? How is this monitored and demonstrated ongoing?

**Which way are regulators leaning?**

As of July this year, operational resilience is a regulatory obligation under APRA's CPS 230 Operational Risk Management. Banks are keenly aware that modernising legacy systems can pose an outsized risk to service continuity. So, the implementation of CPS 230 provides timely impetus to shore up operations in a time of greater uncertainty.

Beyond regulatory compliance, strong operational resilience delivers a raft of other benefits when fully embedded into a banks' operational practices. Real-time monitoring capabilities for process owners, technology and risk owners can help reduce operational risk and operating costs, and enable greater agility to refine processes, products and systems. Embedding resilience practices into the current technology and operations landscape can help to de-risk and potentially accelerate technology modernisation and process re-engineering.

## 4 / Payments

System-wide infrastructure changes, retiring legacy payments to make space for new innovations

### How does Australia's payments system continue to evolve?

Australia has maintained a robust domestic payments system. Alongside the international card schemes (e.g. Visa and Mastercard), we have the New Payments Platform (domestic real-time account-to-account (A2A) payments) and a domestic debit card scheme (eftpos). As geopolitical risks increase, sovereignty of currency and resilience of value exchange become more of a priority. For example, when recently discussing geopolitical and economic uncertainty, Christine LaGarde was quoted lamenting the lack of an EU-wide, domestic payments capability to reduce dependency on the US-based card schemes.

Treasury and the RBA have continued to keep Australia's payments system in focus, with stated objectives of safety, efficiency and competitiveness. Treasury has set a clear roadmap for the payments systems in Australia. This started with the development of NPP and future changes include the decommissioning of legacy payment types, such as cheques and BECS (the Bulk Electronic Clearing System, Australia's primary system for account-to-account payments, including welfare, pension, salary and bill payments – in 2024, BECS facilitated almost 90 per cent of Australian retail A2A payments value).

### How to create perpetual motion?

Changes in core payments infrastructure require coordination across the industry – a new payment type is not successful unless there is a balance between the supply (e.g. pervasive availability at merchants) and demand (e.g. customers want to use it). Due to their scale and customer reach, major banks are the anchors of payments system change.

Changes in payments systems within the major banks requires a balanced approach. The timelines can be influenced by a single bank, but RBA and Treasury will continue to push any outliers back to alignment with the stated industry-wide deadlines. Additionally, payments infrastructure, such as BECS are many decades old, and present the risks that come with deeply embedded systems and processes. All of this is not to mention the customer change management that must be considered. For example, PayTo is a very different experience for an end customer, albeit a more secure and transparent one, as well as a new offering for a merchant – consumers and merchants are both customers of the major banks, therefore requiring focussed change programs to create the network effects needed to make this enhanced payment experience commercially successful, as well as an opportunity to build customer engagement.

### What are the opportunities, and how do you make the change?

Facing into these risks is all part of banks' overall strategic and technology roadmap, and as with any change, there is opportunity that can balance out the risks. As banks seek OOI sources, as well as focussing on customer experience, payments offer an exciting new competitive landscape. Embedded finance partnerships, marketplaces, loyalty programs, and enhanced settlement and reconciliation features are all opportunities to innovate. Making a payment is the most frequent customer interaction a bank has with a customer. Changing customer behaviour patterns can be hard, but once there is a proportion of customers moving to new experiences, the weight of that cohort creates demand – leading to widespread adoption.

Those banks that look for the opportunity and innovation in payments system change, and take their customers on the journey through focussed change programs, have the potential to define customer expectations and lead the market.

| | ANZ | | | CBA | | | NAB | | | WBC | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1H25 | 2H24 | 1H24 | 1H25 | 2H24 | 1H24 | 1H25 | 2H24 | 1H24 | 1H25 | 2H24 | 1H24 |
| **Earnings and returns** | | | | | | | | | | | | |
| Cash earnings | 3,568 | 3,173 | 3,552 | 5,132 | 4,817 | 5,019 | 3,583 | 3,554 | 3,548 | 3,325 | 3,648 | 3,342 |
| Cash earnings (incl. discontinued operations) | 3,568 | 3,173 | 3,552 | 5,133 | 4,822 | 5,025 | 3,559 | 3,501 | 3,598 | 3,325 | 3,648 | 3,342 |
| Cash earnings before tax (A+B+C+D) | 5,087 | 4,600 | 5,062 | 7,405 | 6,931 | 7,223 | 5,115 | 4,997 | 5,098 | 4,845 | 5,274 | 4,833 |
| Core earnings (A)+(B)+(C) | 5,437 | 4,936 | 5,132 | 7,725 | 7,318 | 7,638 | 5,463 | 5,362 | 5,461 | 5,095 | 5,449 | 5,195 |
| Dividends paid (per cash flow) | 2,446 | 2,468 | 2,784 | 4,184 | 3,600 | 4,023 | 2,422 | 2,279 | 2,421 | 2,614 | 3,125 | 2,527 |
| Income tax expense | -1,519 | -1,406 | -1,496 | -2,273 | -2,114 | -2,204 | -1,512 | -1,434 | -1,541 | -1,520 | -1,626 | -1,491 |
| Profit after tax (statutory basis) | 3,642 | 3,128 | 3,407 | 5,142 | 4,722 | 4,759 | 3,407 | 3,466 | 3,494 | 3,325 | 3,648 | 3,342 |
| Return on average equity (calculated %) | 10.0% | 9.1% | 10.0% | 13.8% | 13.2% | 13.8% | 11.5% | 11.5% | 11.6% | 9.4% | 10.2% | 9.3% |
| **Notable items** | | | | | | | | | | | | |
| Notable items (Cash earnings impact) | 0 | 0 | 0 | 0 | -89 | 0 | 0 | 0 | 0 | -140 | 41 | -164 |
| **Revenues** | | | | | | | | | | | | |
| Net interest income (A) | 8,869 | 8,170 | 7,899 | 11,934 | 11,420 | 11,404 | 8,445 | 8,357 | 8,397 | 9,351 | 9,626 | 9,127 |
| Net interest income (excluding notable items) | 8,869 | 8,170 | 7,899 | 11,934 | 11,420 | 11,404 | 8,445 | 8,357 | 8,397 | 9,569 | 9,565 | 9,351 |
| Net interest margin (%) | 1.56% | 1.58% | 1.56% | 2.08% | 1.99% | 2.00% | 1.70% | 1.70% | 1.72% | 1.88% | 1.97% | 1.89% |
| Non-interest income (B) | 2,310 | 2,292 | 2,448 | 2,163 | 2,105 | 2,245 | 1,836 | 1,755 | 1,741 | 1,442 | 1,372 | 1,463 |
| Non-interest income (excluding notable items) | 2,310 | 2,292 | 2,448 | 2,163 | 2,105 | 2,245 | 1,836 | 1,755 | 1,741 | 1,424 | 1,382 | 1,465 |
| Non-interest income as a % of total income (excl. notable items) | 21% | 22% | 24% | 15% | 16% | 16% | 18% | 17% | 17% | 13% | 13% | 14% |
| **Expenses** | | | | | | | | | | | | |
| Total operating expenses (C) | -5,742 | -5,526 | -5,215 | -6,372 | -6,207 | -6,011 | -4,818 | -4,750 | -4,677 | -5,698 | -5,549 | -5,395 |
| Expense/income ratio (%) | 51.4% | 53% | 50% | 45% | 46% | 44% | 47% | 47% | 46% | 53% | 50% | 51% |
| Total operating expenses (excluding notable items) | -5,742 | -5,526 | -5,215 | -6,372 | -6,118 | -6,011 | -4,818 | -4,750 | -4,677 | -5,698 | -5,549 | -5,395 |
| Expense/income ratio (%) (excluding notable) | 51.4% | 53% | 50% | 45% | 45% | 44% | 47% | 47% | 46% | 52% | 51% | 50% |
| Total number of full-time equivalent staff | 43,094 | 42,370 | 40,262 | 49,682 | 48,887 | 48,930 | 39,976 | 38,996 | 38,499 | 35,969 | 35,240 | 35,348 |
| **Asset quality** | | | | | | | | | | | | |
| Credit impairment expense (D) | -145 | -336 | -70 | -320 | -387 | -415 | -348 | -365 | -363 | -250 | -175 | -362 |
| Loss rate (%) (credit impairment expense/total GLAA) | -0.04% | -0.08% | -0.02% | -0.03% | -0.08% | -0.09% | -0.09% | -0.10% | -0.10% | -0.06% | -0.04% | -0.09% |
| Individual provision funding (excl. write-backs and recoveries) | -301 | -264 | -201 | -169 | -181 | -216 | -497 | -544 | -319 | -251 | -210 | -213 |
| Collective provision funding | 14 | -230 | -32 | -221 | -252 | -307 | 42 | 82 | -174 | 76 | 147 | -58 |
| Gross impaired assets | 2,252 | 1,693 | 1,518 | 3,400 | 3,900 | 3,237 | 1,648 | 1,471 | 1,079 | 2,098 | 1,955 | 1,500 |
| Gross impaired assets as a % of GLAA | 0.27% | 0.21% | 0.21% | 0.35% | 0.41% | 0.35% | 0.22% | 0.20% | 0.15% | 0.25% | 0.24% | 0.19% |
| Total provisions for credit impairment | 4,644 | 4,555 | 4,371 | 6,227 | 6,135 | 6,063 | 6,037 | 5,921 | 5,767 | 5,062 | 5,084 | 5,121 |
| Total provisions for credit impairment as a % of GLAA | 0.56% | 0.56% | 0.61% | 0.64% | 0.65% | 0.65% | 0.80% | 0.80% | 0.80% | 0.61% | 0.63% | 0.65% |
| Collective provisions | 4,280 | 4,247 | 4,046 | 5,492 | 5,423 | 5,330 | 5,117 | 5,165 | 5,221 | 4,451 | 4,548 | 4,660 |
| Credit risk weighted assets | 378,081 | 361,185 | 348,447 | 385,117 | 370,444 | 368,735 | 360,486 | 350,891 | 363,873 | 353,233 | 351,724 | 344,633 |
| **Balance sheet** | | | | | | | | | | | | |
| Total assets | 1,302,609 | 1,229,115 | 1,089,699 | 1,308,566 | 1,254,076 | 1,275,969 | 1,095,639 | 1,080,248 | 1,071,005 | 1,098,893 | 1,077,544 | 1,052,661 |
| Total average interest earning assets | 1,142,128 | 1,031,611 | 1,015,621 | 1,135,859 | 1,148,062 | 1,140,693 | 997,072 | 981,048 | 976,422 | 996,701 | 975,402 | 965,785 |
| Total average non-interest earnings assets | 175,841 | 150,112 | 147,375 | 130,141 | 121,713 | 121,513 | 109,887 | 100,896 | 102,651 | 107,602 | 90,278 | 83,152 |
| Gross loans and advances (GLAA) | 823,963 | 807,057 | 718,660 | 977,384 | 949,948 | 929,609 | 756,280 | 738,206 | 725,292 | 829,386 | 811,335 | 789,421 |
| Total liabilities | 1,230,278 | 1,158,487 | 1,018,625 | 1,233,302 | 1,180,988 | 1,203,130 | 1,032,720 | 1,018,035 | 1,009,295 | 1,026,540 | 1,005,492 | 980,101 |
| Customer deposits | 756,564 | 715,211 | 641,090 | 902,502 | 833,725 | 824,575 | 637,896 | 612,796 | 596,546 | 696,762 | 673,615 | 650,946 |
| Total equity (excl. minority interests) | 71,567 | 69,857 | 70,306 | 75,264 | 73,088 | 72,834 | 62,169 | 61,455 | 61,366 | 72,015 | 71,705 | 72,522 |
| Common equity tier 1 ratio (%) | 11.8% | 12.2% | 13.5% | 12.2% | 12.3% | 12.3% | 12.0% | 12.4% | 12.1% | 12.2% | 12.5% | 12.5% |
| Core equity tier 1 capital | 55,229 | 54,469 | 58,412 | 58,871 | 57,691 | 57,231 | 51,236 | 51,139 | 52,543 | 55,007 | 54,648 | 55,764 |
| Total risk weighted assets | 468,999 | 446,582 | 432,779 | 482,369 | 467,551 | 463,644 | 426,445 | 413,946 | 432,553 | 449,495 | 437,430 | 444,417 |
| GLAA / total assets (%) | 63.3% | 65.7% | 66.0% | 74.7% | 75.7% | 72.9% | 69.0% | 68.3% | 67.7% | 75.5% | 75.3% | 75.0% |

Where relevant, comparative information in the table has been restated to align with any restated amounts in the annual report.

# Contact us

**Noel Williams**
*Banking and Capital Markets Leader*
*PwC Australia*

noel.williams@au.pwc.com

**Nina Larkin**
*Partner, Risk and Regulation*
*PwC Australia*

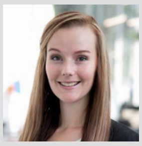
nina.larkin@au.pwc.com

**Tony Richardson**
*Partner, Assurance*
*PwC Australia*

tony.richardson@au.pwc.com

**Barry Trubridge**
*Partner, Financial Services Industry Leader*
*PwC Australia*

barry.trubridge@au.pwc.com



**Alnet Smit**
*Senior Manager, Banking and Capital Markets*
*PwC Australia*

alnet.smit@au.pwc.com

## Contributors

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*Analytical support*

| | |
|---|---|
| Nitesh Chowdhury | Sam Bray |
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| | |
|---|---|
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| Grace Cunningham | Steve Radywonik |
| Lucy Hinton | Spring Li |
| Vanessa Martinez | Keana Yan |



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