# Question and Answer

**Andrew Bowden**
*Head of Investor Relations*

Thanks, Phil. Okay, look, I'm going to make sure I get to one question for everyone this time. That saying, Jon, would you start off with a...

**Jonathan Mott**
*UBS Investment Bank, Research Division*

Jon Mott from UBS. Just a question on mortgage loans, and I know with the book movement, there's a lot of talk, the paybacks as well, but more on the flow of new lending. If you look at your book, naturally, overweight New South Wales with St. George and with Westpac history, also overweight investment property. So they're the hottest areas to the housing market in the moment, especially Sydney investment property. So firstly, there's a couple of parts to my question, Andrew, but the first part is, should you be doing better, given your natural strength is New South Wales and investment property? And secondly, if you go on from that, is there any concentration risk you'll overhit given this Sydney housing boom does continue? Do ever get to a stage where this becomes a concentration risk which could hit that? And another point within that investment property, which we're saying, is Self Managed Super Funds and the growth of these, a lot of concerns around the industry, especially given potentially nonrecourse nature of Self Managed Super Fund investment property lending. Is that something that you are concerned with? And is this something, as an industry, we should be concerned with? So 1 question but with 3 parts.

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

Thanks, John. Well, let me kick off. It might be useful, Brian, to ask you as well to give your thoughts on volumes and your trajectory particularly as it relates to New South Wales. So as you heard me say, we have picked up our lending momentum into the second half. And clearly, that's benefited by the activity -- the heightened activity within New South Wales and, yes, we are well positioned for that. So I think our applications half-on-half are up 16%. It's only now beginning to translate into sort of bottom line growth, I think, in September was the first month that we had a real pickup in bottom line growth, and we achieved 0.9 of system across the group in September. So good to see some of that translating.

I mean, on New South Wales, in terms of a concentration issue, look, I don't think that we're overly concerned about that. I mean, it's markets we know well, our brands are really well established here. Our overall credit quality, as you know, is excellent. All of the metrics and underwriting standards that we have are excellent, so we're not concerned about that.

On the Self Managed Super side of things, look, it's off a small base. I mean, we've got, what's the number, it's about $3 billion, I think, in

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Less than that, yes.

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

Less than that of lending in Self Managed Super. And there's a range of additional requirements that are in place for lending through that kind of vehicle, additional underwriting standards, as well as, obviously, guarantees. But why don't you amplify that answer, Brian?

**Brian Charles Hartzer**

Thanks, Gail. I think Gail has given a good summary, Jon. And the starting point is to say, we're really pleased with our position. I mean, in another life, I would've killed to have market share of 23%, 24% in

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mortgages across the country, and it's a really strong position that's well diversified by state and across our brands as well. So we feel really good with our starting position.

Now we're really trying to run this business sustainably and, as we talked about at the half, our position in mortgages reflected the fact that we wanted to concentrate on deposit growth and quality deposit growth, in particular. And I think growing household deposits at 1.3x system and showing the revenue growth that we were able to get suggest that we played our cards pretty well for this year. But then, as we also said at the half year, we want to increase our exposure to mortgages, as growth is picking up. But we want to do that sustainably as well in the same way that we tackled the deposit piece. And so, as Gail said, we're working across a number of different areas. So starting with the marketing, thinking about our sales capacity, thinking about our sales effectiveness and thinking about the processes that customers go through when they apply for loans. So we've been working on all of those things and the 0.9 of system that we achieved in September suggests that we're getting some really good momentum across that. I can also say that in the last number of weeks, we've had a significant pickup in application volumes beyond that as well. So we feel like we've got some good momentum and heading in the right direction.

From a diversification point of view, again, I'm very pleased to have the position that we've got in New South Wales, biggest state, lots of opportunity and we feel good about that. But you can also expect that we're running the business from very much from a risk point of view. We think that having high-quality credit is got to be one of the hallmarks of Westpac. And so, we are constantly looking at concentration risk and looking at opportunities to make sure that we're well diversified. I think the final point on the credit side, though, is that the loans that we're writing today are the same quality as the portfolio overall. So there's been no degradation. And so, we feel pretty good with that.

On the Super side, Self Managed Super Fund, as Gail said, are less than $3 billion. It has been growing pretty rapidly but we put that through a whole bunch of extra tests: so there are LVR restrictions; there's a lot of advice that has to go around that; we have special people who are looking at those sorts of applications; and we have a number of other safeguards in place. So we think that lending in the Self Managed Super Funds is appropriate for some people, but it's not for everyone, and we're very conscious of our responsible-lending obligations as well.

On the investment property side, that's been something we've been very strong in, in the Westpac brand. I think it reflects the positioning of the brand and the quality of our relationship managers, particularly our LBBs [ph] and our strong position in local around the country. So we feel comfortable with that and the quality of our investment property book, as well, is actually, in some respects, better than the owner occupied. So in general, we're eternally vigilant, but we're very pleased with the momentum and very, very pleased with our starting position.

**Andrew Bowden**
*Head of Investor Relations*

Thanks, Brian. Victor up the back there.

**Victor German**
*Nomura Securities Co. Ltd., Research Division*

It's Victor German from Nomura. I was hoping to ask you a question with respect to Treasury income. I understand it's very difficult to forecast, but it seemed quite significant a decline and I also note that value at risk looks lower in this half. I was just wondering if you can offer some observations in terms of whether there was anything specific that you can call out within for in this half and whether you've changed any of the risk settings? And also, perhaps, if you thought that 2012 or first half '13, second half '12, which is abnormally high levels and we are now entering a more normal environment, just some observations on that?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

It's always pretty dangerous talking about normal environments, but I, look, I do think that the single biggest factor that will drive the outcome in our market-risk activities is the nature of the environment in

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which they're operating. And the more volatile the financial markets, the more value that they can actually derive for the company in managing the risk that they do. And in Treasury, it's managing the full gamut of risk that we have in the balance sheet. And so if you go back in time, you'll see that the times of most volatility around the GFC was the time when they generated the most amount of value.

In the last half, 2 factors I called out that actually underpinned the reduction in revenue -- there's no losses here, we're talking about less revenue. And they are that if you look at credit spreads, they were really flat over the half and the credit curve was very flat. And that's a difficult environment in which to add a lot of value in managing liquid assets. And so, the good income that we generated in the first half was not repeated in the second half. The observation on VAR actually goes more to the management of A-dollar interest rate risk in the balance sheet and, although that there were cash rate declines in the second half, a lot of that had already been built into the market curves, as we came into that second half. And so the lower risk was actually reflective of both lower volatility in the market and lower risk opportunities that were being managed by the Treasury, and that also led to lower revenues. So the risk in measured by the VAR and the returns were very much related. Looking forward, I think the best thing I can do is point you to use your own expectation in terms of how volatile markets will be. Stable markets are actually great for the lots parts of the company, but they're not great for managing market risk and adding value through that.

**Victor German**
*Nomura Securities Co. Ltd., Research Division*

So there were no one-offs?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

No.

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

An extra comment I would make, because I really think we have a great team that's very stable and has been all the way through the GFC with us and Curt and Carl Rowe [ph] and Jo Dawson, and so I'd back them if there's opportunities to add value to do that.

**Andrew Bowden**
*Head of Investor Relations*

Brett?

**Brett Le Mesurier**
*Asia Pacific Prudential Securities Pty Ltd., Research Division*

Brett Le Mesurier, BBY. Well, I, Phil, a question on your net interest margin. The wholesale funding benefit was 3 basis points in the half, notwithstanding the fact you continued to increase the average duration of your wholesale funding. So I've got 2 questions. Sorry, Andrew. First one is if you finished increasing the average term of your wholesale funding? And what's the likely ongoing benefit to net interest margin from the more favorable wholesale funding conditions?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Thanks, Brett. Look, thank you, for actually noticing that we've increased the average return of our wholesale borrowing. It is a real strategy for the company to do that, but also to take advantage of when markets give us those opportunities. And so when there's investor appetite for longer-term in a good kind of risk-return point of view, then we will try to push out our term wholesale borrowing. And so, I don't think we've necessarily finished it. It will, once again, it will be a function of what the opportunities are that we get. We look really hard at what that picture of our maturing profile of term borrowings looks like, because that's -- a point I raised about that was because that is now quite modest, looking forward, if we

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see a situation where lending growth picks up faster than our deposit growth is able to fund, then we have the opportunity to go back into the term markets and raise some more. And so we would do that in the circumstances where lending growth was giving us those opportunities. And part of the idea of pushing out your term wholesale is to give you sort of those sort of opportunities going forward.

In terms of ongoing benefit, we had still, as you look at our maturities in '14 and '15, quite a lot of pretty expensive term wholesale borrowing that is going to run off. And so those benefits will flow through in terms of lower wholesale costs, and they'll flow through as benefits to the margin. But as I also called out, the flip side is we've got a very low-interest-rate environment, and so the hedging on our low-interest balances and on our capital will continue to really offset that benefit on term wholesale. And I see those 2 things pretty much running as offsets, at least for the first half of '14 and probably for the most of 2014.

**Jarrod Martin**
*Crédit Suisse AG, Research Division*

Jarrod Martin from Crédit Suisse. Gail, Phil, we've heard a lot of the banks talk about derisking their portfolios, better credit quality, and particularly, Westpac, prioritizing strength right up there. And in doing so, we're also in an environment where it's a very low credit growth environment. So at the risk of speaking out of school, are banks not taking enough risk? Are banks not providing credit to the economy enough because they're prioritizing shareholder returns over being out to give credit to businesses to grow and ultimately that's to the detriment of the economic growth over the medium term?

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

Look I think the issue is being more just the low subdued environment, there's been less demand, and that's driven obviously very competitive environment for all of us. But there's been less demand, and it's because of the lack of business confidence that we've had all the way through the last 18 months or so, even longer. And that's driven the subdued environment. Now we're beginning to see that pick up and I think all of us are ready and willing to be part of that and support our customers as a turn -- increased confidence to additional investment. So it's been more a function of less demand. I don't think that we are out there not lending and therefore, damaging the economy.

**Andrew Bowden**
*Head of Investor Relations*

James?

**James Freeman**
*Deutsche Bank AG, Research Division*

James Freeman from Deutsche Bank. Actually very similar to Jarrod's question. Just wanting to sort of understand the balance sheet strength and the conservative settings that you talked about. What we've sort of estimated is that it's costing you somewhere in about 1% to 1.5% off your ROE? What kind of environment changes that where you actually are happy to let go of the credit quality you're holding, let go of the capital, let go of the liquidity a little bit more to help sort of realize that return opportunity for shareholders? What kind of conditions do you need to see or are you basically just setting Westpac up for a solid sound lower ROE bank?

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

Well, let me start, and Phil you can add in. Look, I think we've done a good job this year, if I may, if you think about ROE up to 15%, so a good -- up to 16%, so a good increase in ROE. If you look at our Tier 1, a very strong, up to 9.10%. So we've really strengthened that through as Phil indicated in his remarks, through the performance of the group and the organic growth and cash earnings within the group. So I think we've done a really good job. If you look at our revenue over this past year, we're 4% up in revenue. And although, and there's some other banks may have had higher lending growth, we have had higher revenue growth overall. So I think discipline and consistency and balance are the kinds of things that we

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want investors to have in their mind when they think about the Westpac group. But with that, Phil, you may want to give a bit more.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Look, I think the construct of that risk, return, growth and productivity is the way we think about it. And as Gail mentioned, we certainly have had a heavier prioritization of strength and return in the last 2 or 3 years. And that, we think was the right thing to do. And it's allowed us to position ourselves to meet kind of regulatory hurdles. It's allowed us to improve our overall returns. And you can see the benefits of it flowing through in terms of the capital ratio, because your lower risk-weighted asset growth because of high credit quality leads straight through into your better capital ratio. But we're not a believer that you want to keep strengthening the company forever. And as Gail mentioned, we are looking to see -- to use that stronger base now to move towards both financing with the capital sense and with the funding sense additional growth. And we think that, that's the way to play it. It has been a low period of credit growth, so it's been a great opportunity for us to improve the funding position of the balance sheet, as well as the capital. But you don't do that forever, and you do it for the purposes I mentioned, which is to position yourself to better growth coming forward. I don't think we sit and feel that we've got a lower ROE as a consequence of that. We think, over time, the recalibration of capital and the equalization of that capital across the group will allow us to have the relative capital position and relative ROE position that's appropriate for the company and it will be better.

**Andrew Bowden**
*Head of Investor Relations*

Richard?

**Richard E. Wiles**
*Morgan Stanley, Research Division*

It's Richard Wiles from Morgan Stanley. Phil, in the 23rd, I knew your revenues grew at a slightly lower rate than your expenses, and that's actually consistent with what you said last year in your outlook commentary, you're looking to manage revenue and expense growth to achieve core earnings growth. I have 2 questions. Firstly, why are you targeting core earnings growth rather than positive jaws? And on Slide 12, you show the annual expense savings. Can we expect them to go up or go down in 2014?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

I guess the answer to the first part of the question, Richard, is that, with -- the whole point of positive jaws is to grow core earnings growth. But you can achieve a positive jaws and subachieve on core earnings growth. If we don't invest for future revenue, then in this particular period, we can have lower expenses and positive jaws. But that won't give us the better core earnings position in the future. And so we've tried to continue to focus on giving ourselves the capacity to invest for future revenue and recognize that we have to gather, live within those means from period to period. But we will constantly look to see if we can get higher revenue growth because, frankly, when your cost income is at 40%, then every dollar of revenue growth generates a decent core earnings feature, and so that's our challenge. The challenge we give our operating divisions is to find productivity savings year after year after year to offset the natural increase in their operating cost and to give us the wherewithal to continue to invest. And that's what we've been doing in the last few years, and that's what we'll continue to do. The challenge is if we don't find those savings, then you start to think what we can invest less and what does that mean for the future. And so all of our operating divisions understand that is the requirement on them, and they start every year thinking about how am I going to position the company and their part of the company to be in a better position starting the following year in terms of productivity savings they've been able to identify.

**Richard E. Wiles**
*Morgan Stanley, Research Division*

And the expanding expenses for the expense savings next year, Slide 12?

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**Phillip Matthew Coffey**
*Former Chief Financial Officer*

If it's to do with productivity savings, then I will think I was trying to answer it by saying, we will continue to have the focus on driving our productivity savings to offset those operating cost increases that will come again with this in 2014.

**Richard E. Wiles**
*Morgan Stanley, Research Division*

But why -- I can understand why the investment spend is not set at the start of the year, I would've thought you'd have a pretty good idea on what level of productivity benefits you've got locked to.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Yes, and they are...

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

To offset the operating cost.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

To offset the operating cost increases that we will be having as a consequence of wage increases, inflation, et cetera, et cetera.

**Andrew Bowden**
*Head of Investor Relations*

Mike?

**Michael Wiblin**
*Macquarie Research*

This is Mike Wiblin from Macquarie. And just another question around the offsets. Phil, you talked sort of about the wholesale side of things, which will help on the lower rates and liquidity drag. Your deposit performance has been excellent, again, but it has been a bit of a drag on the margin. I mean, are you finished there or do you think there's a bit more to go? And how does that play into the margin, is that still a drag or not a drag or actually even a tailwind hitting into next year?

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

We focused -- we haven't got to that huge journey of moving from 52.6% deposit-to-loan to now being over 71%. It's now more of a focus on the quality and mix of the deposits, particularly as we move towards an LCR regime. I mean the deposit-to-loan instruments are pretty blunt instrument really, but the LCR is going to be the new marching orders for us. So quality of deposit seems to grow through transaction accounts and growth of household. On the margin side, it's been a drag, as you said. However, I think there's been some signs of improvement over the last while. I hesitate to say, it's going to be a tailwind from, but it's certainly been less a negative.

**Andrew Bowden**
*Head of Investor Relations*

Brian.

**Brian D. Johnson**
*CLSA Limited, Research Division*

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Brian Johnson, CLSA. I have a question for Mr. Whitfield, if I may. Rob, if you ever look last year, we had 2 halves, we had about $65 million of charge and this result, and you begged me relentlessly about how good the asset qualities would sent 2 halves where you've had $45 million gain each half year. We also saw quite a chunky release in the expected loss of something like $200 million, back which is on Page 46. Can you just talk to us about -- can we expect another half of a gain going forward and what that might mean for the expected loss?

**Robert Whitfield**
*Former Chief Executive of Westpac Institutional Bank*

Thanks, Brian. And thanks for finishing with a congratulations, because the impairment story is one that I have been sort of emphasizing to you and to others for a very long time. And it is the result of many, many years of very disciplined risk management practices. We have a fantastic credit team and we really focus enormously on the asset quality of our book, and that goes from the front-line relationship managers all the way through to the support teams. In terms of 2013, you're quite right. We saw a positive benefit in both years and if you look at the composition of that positive benefit, as Phil pointed out, a large part of that was a lower individually assessed provisions going into 2013. As I look at the book going forward in 2014, there is nothing that concerns us that things that's likely to change with what we can see today, but it's very dangerous of course to predict what the environment is going to bring and what sort of credit conditions we'll see. But with the environment, we do expect to see and the conditions we expect to see, there are no large surprises that we can see on the horizon. So the quality of the book should continue to play as a strength for this year's banking 2014. In terms of whether that's going to be positive or negative, as Phil said, we don't give guidance on that.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

And just to add on the rate expected downturn loss, I think, point I'd make, Brian, is that the fact that, that dropped as much as it did in the half. I think is totally consistent with what we're saying around the improvement and the quality of the overall book.

**Brian D. Johnson**
*CLSA Limited, Research Division*

[indiscernible]

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Yes. We've made and -- obviously, across most commercial exposures, but WIB is a big part of that.

**Andrew Bowden**
*Head of Investor Relations*

Okay, good. Couple of questions on the phone. We'll take one from Craig Williams, please.

**Craig Anthony Williams**
*Citigroup Inc, Research Division*

Harmonized core of your Tier 1 was 11.6% and global minimum requirement is 7%, so that seems to suggest that you currently already have a very large buffer to accommodate the SIPs or counter cyclical buffers or the like, doesn't it? And the special dividend again this half sort of reflects that, and given core of your Tier 1 has increased from about 4% in a group level equivalent to something like 9% now on core of your T1 since 2007 to today and ROE remains strong 16% to -- or 20% plus on a tangible basis, investors shouldn't have too much cause for concern about returns you're going to achieve in the event that capital buffers are required to increase, is there?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

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What can I say, something smart, like I get you to give Epper [ph] a call, Craig. But I won't say that. What I will say is I think, you're right in terms of highlighting just how strong we are in particular when you look at us from a global perspective in terms of the capital that we're holding. And we feel great about that and increasingly, I think it's recognized by global institution investors as well, just how strongly capitalized Australia -- Australian major banks are and Westpac in particular. How we move into accommodating the D-SIB is something that we'll all have a greater idea of, in the next few months, and what impact that might have on ROE, likewise. We'd be hopeful that we'd be able to do that in a sensible way, and reflecting the way that we've already set the company up in terms of having a strong capital position.

**Andrew Bowden**
*Head of Investor Relations*

A question from Andrew Lyons on the phone too, please.

**Andrew Lyons**
*Goldman Sachs Group Inc., Research Division*

Just a question on capital, in the second half of 2013, you've seen your IRRBB risk-weighted assets charge nearly half. The commentary suggested that is largely due to a new regulatory model getting approval from APRA. Just 2 questions, is there anything else in that reduction in the IRRBB charge? And secondly more broadly on capital, I'll just be interested in any comments you can make just on the opportunity you think you still have to further manage or optimize your risk-weighted asset?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Andrew, on the IRRBB, that was actually during quarter change and was processed through the Pillar 3 documents then and there's nothing else other than the model changes that we called out then, just that, I guess, gets more attention when you put it into the full year results as well. But no, there's nothing else to call out there. In terms of other opportunities, look, I think the biggest opportunity for the company is to continue to run our divisions with a really keen focus on the amount of capital that they consume and the returns they get in for that capital. And as that's being cascaded down through into the front-line, whether it be on an individual relationship manager basis, in an Institutional Bank or into various sort of segment analysis that Brian is doing, we're seeing the front-line think of ways to actually improve the way they can get a return on that capital. And that is, I think, the most encouraging thing in terms of feeling confident about how we're going to be able to continue to both achieve the right amount from a regulatory point of view, but also keep our ROE in good health. We don't have anything other than what I've already called out in terms of the major moving parts, which are obviously D-SIB, but also how the conglomerates rules finally get landed, and they will be, I think, significant issues over the course of 2014.

**Andrew Bowden**
*Head of Investor Relations*

Andrew?

**Andrew Hill**
*BofA Merrill Lynch, Research Division*

Andrew Hill from Bank of America Merrill Lynch. Just question again on credit quality, If I look at Slide 54, at the impairment charge off, right, that's 16 basis points this year, it's lower than it's been in more than a decade. If I look at your forecast for unemployment for next year, you've got it going up to 6.5%. I'm just wondering, where is the stress point in terms of unemployment given you -- they seem fairly comfortable on the credit quality outlook? And secondly, given the changes that we've seen -- been seeing in the property market in terms of confidence indicators, are you starting to think that, that unemployment rate might not go as high as you're actually forecasting?

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

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Well, I'm hopeful it won't go as high as what we're forecasting. Bill Evans is in the room here, and those are -- Bill's been consistent in that forecast for some period of time. It also drives Bill's forecasted view that interest rates, cash rates, again, to come down to 2% during the course of the 2014 year. I'm hopeful it won't go as high as that. We have of course seen unemployment higher than that -- and continued with excellent credit quality. So I'm not concerned that from a stress testing point of view, we've got a range of things that we do in the mortgage side, for example, we put buffers in, as you'd be aware, so that we can assist individuals relative to a much higher cash rate environment in terms of their ability to repay. So I -- we've been there before, in 2008, was in fact probably the most stressed year from a point of view of higher interest rates and higher unemployments and our mortgage book held up particularly well. So that was a very good active live stress test for us. So that's your first question, what was the second one, again?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

I think there's a question around 16 basis points versus the history, is that the question, Andrew?

**Andrew Hill**
*BofA Merrill Lynch, Research Division*

That was the first question. The second question is really around just in terms of -- it seems as though you think things are getting a lot better. Does that mean that your forecast around the macro is starting to shift?

**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

Yes. Look, I think, cautious about that still. There's more optimism, no doubt and clearly, some of that is being driven out of the election results and the open for business direction that the government has now sit. So there's definitely more optimism. It takes a while for that consumer confidence and business confidence to actually translate into activity. On the consumer side, we're seeing some of that increased confidence translate into housing activity, particularly in New South Wales and Western Australia, but it is still patchy, and I'd still say, relatively cautious. In the commercial side, again, more activity, high levels of confidence coming out of confidence surveys, so business is saying they feel more confident about the future. But you ask them, does that mean that they're going to do something today? The answer is no, not yet. So I'm still relatively cautious about the timeframe through which this heightened confidence is going to translate into actual credit pickup. But I'd much rather be where we are today than where we were a year ago, because having confidence is the first start down that path. So our actual forecast for credit growth, credit growth would have been around 3, 3.5 this year. We would expect that to go up to about 4.5 next year. Mortgage, credit growth is being about 4.5 this year. We expect that to be 5.5 next year. And business credits has been lower this year. We'd expect that to get to 2% to 3% next year. So that's as we see it right now.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Yes. I'll just add on that chart, Andrew, 2 things to obviously call out: One is under the incurred loss model, you've -- probably the lower at the bottom of the cycle and maybe higher at the top of the cycle, we'll wait and see. Hopefully, not too soon. But the other thing to kind of bear in mind is that our portfolio today post the St. George merger has a heavier weighting of mortgages than what we had in the early 2000s. And so, given the low loss rates that you run on the mortgage book, you should expect that other things being equal, that the picture today should be actually with a lower benchmark than what we had earlier.

**Andrew Bowden**
*Head of Investor Relations*

Chris?

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**Chris Williams**
*UBS Investment Bank, Research Division*

Chris Williams from UBS. I've got a question about leverage, and if we look at Slide 25, where you highlight the dramatic 94 basis point increase in your regulatory capital ratios across the course of the year. That's suggesting that through a regulatory lense, your leverage actually declined by 11% during the course of the year. If we then flip back to Slide 20, and you're measuring leverage against your average interest earning assets, it suggests that leverage actually made no contribution to your improvement in ROE. So my question is, how long can we continue to see a divergent view between your interest earning asset view of leverage and your regulatory view of leverage? And the second part of the question is that we heard a lot about pro-cyclicality back when risk-weighted asset growth would outpace assets and lending growth. We hear very little about pro-cyclicality when risk-weight asset seem to never grow in this new benign environment.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

Okay. Look, on leverage, I've actually think the way to think about is, against your average interest earning assets and because the regulatory capital can benefit from changes in the risk components of your assets, as opposed to the overall level of assets that you're carrying, and so we would mostly point to that slide on Slide 20, as the picture of what's happening with our leverage. And I guess the point is, I don't think we should get overly fast, leverage may increase, just important to know what is the driver of your improvement in ROE. At the moment, because of the low credit growth environment that we've had, our ROE improvement has not been as a consequence of leverage. But that could happen in the future, and that would be actually a pretty good thing. But it's because we'd be able to be growing our business into a higher ROE. What was that, the pro-cyclicality question?

**Chris Williams**
*UBS Investment Bank, Research Division*

It really about the extent of pro-cyclical benefits in your risk-weighted asset base?

**Phillip Matthew Coffey**
*Former Chief Financial Officer*

I think there's no doubt that you get through, if first, you do get pro-cyclicality impacts and we are obviously seeing some of those benefits now. I don't think we would ever shy away from that, but you're almost always through cycles have very long periods of actually pretty benign credit, and then some pretty big sparky years of bad credit. And that they are quite small, they give you an average that's higher, but the distribution is not a normal curve, as you know, in terms of the outlook for impairment costs. And we are in that period at the moment of lower impairment costs than the average, but that can continue for quite some time.

**Andrew Bowden**
*Head of Investor Relations*

One last question at the back.

**Scott Robert Manning**
*JP Morgan Chase & Co, Research Division*

It's Scott Manning from JPMorgan. On the resumption of business -- sorry, mortgage credit growth that you're looking for next year, one of the things the market has pointed to time and time again over the last couple of years has been the pricing relative to peers. And you've been happy to run a higher discount strategy to give like-for-like pricing and you've been happy to grow it below system while credit growth has been low. How are you thinking about the application of that discount as you look to resume momentum in that business, and therefore, whether it becomes sticky to unwind that discount going forward, as you do increase the rates of growth? And secondly, you're looking to target more growth through the broker network, or change that proportion, or is it purely through the proprietary channel?

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**Gail Patricia Kelly**
*Former Chief Executive Officer, Managing Director and Executive Director*

I can see Brian wants to answer his question. But let me take of -- I don't think that we -- as you know, large proportion of our customer, especially in the Westpac brand, have a 70 basis point discount. And obviously, from time to time, depending on the size of the loan, depending on the customer, we give a higher discount, I don't think we're discounting any more release than our peers an average. And we pay a very close attention to the margin of the back book, as well as the front book. But as you heard me say, and Brian mentioned in his earlier remarks, there are a range of things that we're looking at to make sure that we can sustainably lift from 0.8 to a 1 time system that go to consideration, marketing promotions, sales effectiveness, service improvements and the likes. So this is going to be really disciplined, it's not just a simple equation of volume prices, there's a lot more to this. And the fact that we have a range of brands that we can work with as well: St. George; Westpac; RAMS; Bank of Melbourne; BankSA. So the range of brands too that give us some degrees of freedom and flexibility and what we target, how it target and how we go about it. But Brian, do you want to pick up especially on the mortgage broker piece?

**Brian Charles Hartzer**

Sure. Thank you. Well I think that's a good opening for this. And the main point that I would say, is we're trying to run this business in a sustainable way and we think very much about our overall net interest margin, not just the margin on a particular mortgage product. So as we've managed our business this year, we're thinking as much in a way about deposit margins as we are about mortgage margins. And then within that, we have a whole bunch of different levers that we can use. So there is the headline rate of course, but then we also have funding cost to consider. We have product mix. We have business mix. And I think with respect to the overall question of discounting, we don't believe we're discounting more than our peers and we see that in our overall data. We do come in and out of the market from time to time, depending on what we're trying to do. But we're very conscious about what's, what do our pricing actions doing to our overall margin? And what's happening to our exit margins versus the portfolio margins? So given the things that we've done this year, when we look at the exit margin on mortgages, it's actually above our overall portfolio of margins. So that says to us that we're managing that pretty well. But again, I would come back to really the key thing here is, there seems to be this incredible focus on headline rates versus growth. What we actually see is these other factors like the marketing, like the sales capacity, the sales effectiveness and process has as much to play in as anything we might do on price.

**Scott Robert Manning**
*JP Morgan Chase & Co, Research Division*

And broker utilization?

**Brian Charles Hartzer**

On broker as well, we think brokers are an important part of the mix, but we certainly feel that our biggest focus is on first party and we've seen a lot of the focus that we've had on sales effectiveness has helped lift the first party growth. So our use of brokers has been recently stable and we expect it to stay there.

**Phillip Matthew Coffey**
*Former Chief Financial Officer*
All right, with that, thank you very much, and good morning.

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