Westpac Banking Corporation

2018 Annual General Meeting

Perth, Australia

Wednesday, 12 December 2018

Chairman’s Address

Lindsay Maxsted

It is a great pleasure for the Westpac Board to be here in Perth; it is one of my favourite cities.

As many of you know, Westpac is Australia's first bank and first company and last year we celebrated our 200th anniversary. Our rich history is something of which we are very proud.

We share that history with Western Australia where our roots trace back to just 12 years after the new colony of Perth was established in 1829.

It was then, in 1841, that the Western Australian Bank was established. This was the second bank to open in Perth when George Frederick Stone sought to create a true local alternative to the only other bank operating at that time. The Bank of New South Wales first began working with Western Australian Bank in 1854 operating as its agent in other States. While rumours of more formal links had persisted for some time it was not until 1927 when the two entities merged creating one of the largest banks in WA at that time.

Westpac's history also traces back to the Perth Building Society which opened its doors in 1862. Many of you will recall that the Perth Building Society merged with Hotham Permanent Building Society to create Challenge Bank which was subsequently acquired by Westpac in 1995.

And so while we cannot claim to be the first bank in Perth, we can claim to be the second bank, the longest serving bank and the first building society.

This year has been particularly challenging for financial services entities, including for Westpac and for you, our shareholders. The sector has been the subject of intense scrutiny from Government, regulators, the media, and the community generally.

Far and away the greatest impact on public sentiment has been generated by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission). I intend to devote part of my address today to the Royal Commission, just as I did in my annual letter to shareholders in the 2018 Annual Report, as coverage has been extensive and many shareholders will have been shocked by some of the revelations. Indeed in reading the questions submitted by shareholders prior to this meeting, it is clear that many are disappointed, angry and upset by issues raised by the Royal Commission.

Moreover, you may feel a disconnect between the Vision and Values of Westpac and the actual or alleged misconduct highlighted by the Royal Commission. In this regard, you are owed an explanation to help bridge that disconnect and to understand how we intend to respond to the important issues the Royal Commission has raised.

First and foremost, you should know that Westpac and your Board have taken the process of the Royal Commission very seriously. We have devoted significant time and resources to providing material, supporting our witnesses and responding to both Westpac-specific matters, and general policy questions. We will of course continue to do so until the final report of the Royal Commission is released.

The Royal Commission in context

Now let me endeavour to put the Royal Commission into context for you as Westpac shareholders. The terms of reference of the Royal Commission are instructive. It is an Inquiry into *misconduct;* it is not an investigation into all aspects of financial services or indeed into conduct generally.

The Letters Patent establishing the Royal Commission create this focus noting at the same time that "Australia has one of the strongest and most stable banking, superannuation and financial services industries in the world, which performs a critical role in underpinning the Australian economy." The Royal Commission does not challenge these important observations.

So although the Royal Commission has clearly focused on matters of extreme importance, it has captured only a fraction of the activity taking place inside financial institutions.

The Commissioner commenced his enquiry by asking entities to submit details of conduct over the previous ten years identified as either misconduct, or conduct that fell below community expectations. These submissions, together with other information gathered, have been subject to scrutiny and informed the themes identified by the Commission. For Westpac, your Bank, much of this conduct is historical, has been previously self-reported to regulators, and in many instances, has been resolved or is being addressed.

Given this context, we need to be mindful in generalising what the Royal Commission is finding and reporting, including across different organisations. There is also a risk that the misconduct raised at the Royal Commission may inadvertently come to define the culture of the sector. Speaking for Westpac, that is not the case. From that perspective, it is challenging for the Royal Commission to form a view on overall culture when, by its terms, it is focused solely on misconduct.

Lessons for Westpac

That said, we have looked closely at what has emerged from the Royal Commission and have summarised that into 4 key lessons for Westpac:

First - We did not sufficiently understand and analyse customer complaints and, in many cases, they were not dealt with promptly enough. While the vast majority of our 12 million customers in Australia have a positive experience with Westpac, we did not focus enough time, resources or empathy on the customers we had let down.

Second - We were slow to focus on certain non-financial risks. In the aftermath of the Global Financial Crisis, we quite properly focused on the financial risks of credit and liquidity and lifting the overall strength of the balance sheet. And in so doing, we devoted insufficient attention to conduct, compliance and reputation risks. This was compounded by a raft of ever-increasing, and at times overlapping, rules and regulations.

Third - Some employee remuneration arrangements inadvertently contributed to poor behaviour. While remuneration is not directly related to all of our conduct failures, there have been instances where our remuneration practices may have contributed to poor behaviour.

And finally, we did not fully appreciate the underlying risks in the financial planning business. Better training and supervision, changes to the way financial planners were remunerated, and better documentation of advice was required.

Needless to say, we have moved to shore up the resources, systems and related reporting to deal with any shortcomings. We are also accelerating customer remediation, recognising that where we have made mistakes, we need to promptly fix these issues for customers.

Shareholders should know that addressing these issues is our priority and we are absolutely committed to restoring the standards that you, the community, and customers expect.

Without diminishing these negatives, this intense scrutiny has also reinforced some very positive aspects of Westpac.

First - We are an organisation that has long taken a “customer first” philosophy very seriously. This approach is not only enshrined in our vision, it is clear from the actions we have taken to deal with some of the shortcomings identified. These have included the appointment of a Customer Advocate, Adrian Ahern, to create a new, independent approach to resolving long-standing issues and providing objective feedback on how we can better manage complaints. Adrian is here today should shareholders wish to talk with him.

We have also elevated the management of complaints to the Executive Team with the appointment of a new Group Executive for Customer and Corporate Relations. And we have established a new Vulnerable Customer Council – to better support customers who may be at risk, and to help them to avoid hardship and financial harm.

Second - We have always understood that to provide satisfactory long-term returns we must be conscious of all stakeholders’ needs. We are not an organisation based on “greed” or on short-term profit. We have consistently made decisions that are focused on the long term sustainability of the organisation rather than short term gains and it is a key reason why many employees join and stay with us. For example, we were the first Australian Bank to sign the Equator Principles; the first listed Australian company to introduce paid maternity leave, and we seeded Australia’s largest corporate scholarship program with $100 million to create the Westpac Bicentennial Foundation. This year, we set aside $100 million in lending to support farmers, we led the market in removing grandfathered commission payments in BT and we lifted our lending to climate change solutions to $9.1 billion.

Westpac has been consistently rated a sustainability leader by external governance bodies. This has included being a leader in the Dow Jones Sustainability Index for much of the last decade. In 2018, Westpac ranked 17th globally. Separately, reflecting our commitment on all these fronts, employee sentiment has remained high relative to peers notwithstanding this extremely difficult year.

The Third positive from this intense scrutiny for me is that we have continued to lend prudently all through the recent period. Notwithstanding recognised issues with certain processes, our detailed work has confirmed that the credit quality of our mortgage portfolio remains sound, with Australian delinquencies remaining low and properties-in-possession down on the same period last year.

As a bank whose success is linked to the fortunes of Australia and New Zealand, we have no interest in lending to individuals or companies who cannot repay their loans.

This has not changed over recent years and it is not something the Board would tolerate. Unfortunately, recent market commentary continues to imply that banks are lax in their standards, lend irresponsibly and processes are prone to systemic fraud. For Westpac, this is just not true.

That is not to say there have not been some shortcomings, instances where we have let down a customer, or where we've been subject to fraud. When we do find issues, we act promptly on our processes or on any individual or third party involved.

Shareholders need to only look to the outcomes of our lending for evidence. Today our credit quality metrics remain near cyclical lows across both businesses and consumers. In mortgages for example, less than 1% of our mortgage loans are more than 90 days in arrears, and for a portfolio with an exposure of more than $550 billion, the losses in 2018 were $86 million.

And finally, our purposeful, consistent and large investment in technology has been confirmed as the way forward to further improve the customer and employee experience, and to build shareholder value. In 2018 we have had particular success in commissioning a new private cloud infrastructure, greatly reducing our storage costs, enhancing flexibility and slashing the time needed to create capacity for new initiatives. We have continued with the development of Panorama, our funds administration system, rolling out new reporting functionality and enhancing the mobile app. And, very importantly, we have reached major milestones on development of our Customer Service Hub, the Group's multi brand operating system. The system is now in pilot and will go live with new Westpac mortgages in 2019.

2018 Financial Performance

Let me now turn to our results. In 2018, our financial performance was mixed; we have further built on the balance sheet and financial strengths that are a hallmark of Westpac but our annual profit was relatively flat over the year. Cash earnings, our preferred measure of performance, for the year ended 30 September 2018 was $8,065 million, $3 million higher than the 2017 financial year. Our reported profit reached $8,095 million, up 1% in Full Year 2018.

The Group began the year solidly with good growth and well-managed margins in the first half. Conditions in the second half however were more difficult with higher funding costs, lower mortgage spreads, and a reduced markets and treasury contribution. In addition, we needed to lift provisions associated with customer refunds and regulatory/litigation costs as we address some of the legacy issues alluded to earlier.

On the balance sheet, the story is a strong one. At 10.6% our common equity tier 1 capital ratio remains above APRA's unquestionably strong benchmark and with $154 billion in liquid assets the Group has significant funding flexibility. Our two key liquidity ratios, the Liquidity Coverage Ratio and Net Stable Funding Ratio, were both comfortably ahead of regulatory benchmarks.

Credit quality has continued to be a highlight with all dimensions of the portfolio in good shape. The ratio of stressed assets to total committed exposures has remained near cyclical lows at 1.08%.

This strength in our balance sheet has continued to come at a cost – increasing shareholders' equity, lifting shares on issue and maintaining a strong liquidity position impacts returns. More specifically, as a result of the increase in shares on issue, our cash earnings per share of 236.2 cents was 1% lower over the year while the Group's return on equity (ROE) was 13.0%, down from 13.8% in 2017.

Dividends

This year the Board has determined a final dividend of 94 cents per share, which is unchanged over the prior half and consistent with the final dividend for 2017. This brings the full year dividend to 188 cents per share, unchanged from 2017.

In setting the dividend, we seek to maintain a payout ratio that is sustainable over the long term. That is, we aim to retain sufficient capital for growth and maintain an unquestionably strong capital position. At the same time, we want to maximise the distribution of franking credits. The Bank Levy, which cost an equivalent of around 8 cents per share this year, was also considered.

The 94 cent final dividend represents a dividend yield of 6.7% based on the closing share price at 29 September 2018, or a yield of over 9.5% after adjusting for franking. Today that yield is now closer to 7.5%.

The final ordinary dividend will be paid next week on 20 December 2018.

Remuneration outcomes

Executive remuneration is always of great interest to shareholders, and a high percentage of questions we received for this AGM were on this topic.

An important role of your Board is to approve remuneration outcomes for the CEO and Group Executives based on Westpac's total performance, including financial, risk, customer, people and reputation outcomes.

We take this responsibility seriously and have devoted significant time to the process. This year has been particularly complex given the environment and the back-drop of the Royal Commission with its impact on community expectations.

While the poll on the remuneration report has not been taken, based on votes already received, more than half will be against this resolution. This means we will incur a first strike. This sends a strong message to the Board.

Feedback from shareholders has varied, but the key point from those voting against the remuneration report has been that although the Board took events over the year into account, many have questioned whether we went far enough, particularly in reducing short term variable reward paid to the CEO and other Executives.

I want to assure you that the Board is here to represent your interests and that remuneration judgements this year were based on growing the long term value of your company. Our decisions were a considered view based on total outcomes for the year. While earnings were flat, and we have fallen short in areas such as financial advice and managing customer complaints, our performance across other dimensions such as balance sheet strength, customer growth and employee satisfaction has exceeded expectations.

In assessing short term variable reward performance, outcomes were below target for economic performance and for customer and service related areas of the annual scorecard. In addition, the Board reduced scorecard outcomes to reflect collective accountability for risk and reputation matters.

As a result, this year's short term variable reward for the CEO and Group Executives in Australia were, on average, 25% lower than last year. The largest individual year on year reduction was 50%. The CEO's short term variable reward outcome was $900k or 30% lower than last year.

I would also highlight that no long term variable reward vested this year and so around one third of the CEO and Group Executive's potential remuneration was forfeited; equivalent to around $18 million. This is entirely consistent with the relatively weak performance of shares in the banking sector, including Westpac, over the last few years, including the 2018 financial year. Putting this another way, for the CEO, his total variable reward outcome was 36% of his total target variable reward.

However, let me reiterate that the Board takes your feedback very seriously. Given the many concerns expressed we will reach out to more shareholders this year to fully capture and understand your views. In the year ahead we will continue the work we have already started to review our reward frameworks, with particular consideration of the concerns raised. As part of this, we will share the changes with you, together with the Board's thinking on those changes.

Board changes

Strong governance is underpinned by a strong Board. Bringing together the right mix of skills and experience and succession planning are critical elements of my role as Chairman.

Over the year we appointed two new directors on the Board with Peter Nash starting in March 2018 and Anita Fung joining the board in October 2018.

As a former Senior Partner at KPMG, including serving as the National Chairman of KPMG, Peter Nash brings significant financial, accounting, risk management and strategy expertise to the Board. During his time at KPMG, Peter worked as the Lead Audit Partner for another major Australian bank and so he also brings a deep understanding of the risks and workings of Banks.

Anita is a highly respected career banker and our first Board member residing outside Australia and New Zealand. With her extensive experience at HSBC in Hong Kong, Anita adds new international banking and financial services experience to your Board.

Craig Dunn is up for re-election at this AGM and I will say more about Craig's contribution just prior to the resolution.

We also announced that Peter Hawkins would retire post today's AGM. Peter Hawkins first joined the Board in the volatile times of 2008, and with his deep banking experience helped steer this company through a decade of significant change. Personally, Peter has been a great support to me and an excellent shareholder advocate and I wish him all the best in his future endeavours. While leaving the Board, we will continue to benefit from Peter's expertise as a member of the Bank of Melbourne Advisory Board.

As part of our detailed Board renewal process, we are likely to announce the appointment of two new Non-executive Directors in the first half of calendar 2019.

My commitment

There is one final, very important point I wish to raise. Your Board is here to represent shareholders and we shall unashamedly continue to do so, including striving to provide you with the best possible returns on your equity over the long-term. We understand that for a well-run bank, or indeed any commercial organisation, this will not, and cannot be, at the expense of the customer. The most successful organisations treat their customers and employees well, and from there the financial returns flow.

Thank you for listening and thank you very much for your ongoing support of Westpac which is greatly appreciated. I now ask our CEO, Brian Hartzer, to address the meeting.

Ends…