Suncorp Market Update

5 February 2009

John Mulcahy: This is John Mulcahy. Good morning. Thank you very much for joining us at such short notice. I'm joined here in Sydney my Chris Skilton, our CFO. I should point out at the start of this that we'll be going through the teleconference in two parts, and that's really for international legal reasons. And US investors will not be able to participate in the second part of this presentation.

I hope that you've all had the opportunity to read the various announcements that we've made to the market this morning. But before Chris and I take you through the market update material, I would like to just take a moment to talk about the announcement that we've made concerning my future.

Now I've been a CEO of Suncorp for six years, and I have agreed with the Board that now is the appropriate time for the company to transition to a new leadership. Given the important capital raising announcement today, I think it's appropriate, and we agree it's appropriate, to announce that transition this morning.

I have to say that I've enjoyed my six years at Suncorp. We're very proud of what we've achieved. I started back in 2003. At that stage, we were a functionally structured organisation, completing the integration of GIO. Subsequent to that, I guess the highlight was the acquisition and the integration of Promina, which I believe has now positioned Suncorp very strongly in the marketplace.

And I think that this capital raising will certainly ensure that we are in a robust position to capture the opportunities that the changing financial markets will provide for Suncorp. So I've agreed with the Board that I will remain with the group as we go through that transition to a new leadership.

I would really like to assure the shareholders on the line, as well as any of our people from Suncorp on the line, that I will certainly undertake my duties with the same diligence and enthusiasm that

I've done in the past. So with that little personal item out of the way, I would like to move to the agenda for the market update.

And really the purpose of today is to provide an update of our performance to the half year, to 31 December 2008; and to ensure that the market is fully informed of any material factors relating to the business in advance of our foreshadowed capital raising initiatives. At the outset I'll provide a brief high-level overview of the group's expected results for the half and then I'll ask Chris to run through each of Suncorp's operating divisions in more detail and also update our December '08 capital position. I'll then return to summarise our outlook and then we'll open the floor to questions, and then we'll have a short break and move on to the second part of the presentation.

So if I can move on to slide four. Before we talk through the P&L details I want to make it clear that the figures we're presenting today are preliminary and unaudited. Although we have a high degree of confidence in them there may be some variation in the results announcement that we would make in normal course on 24 February.

One particular point that I would like to point out is that we remain in discussions with our reinsurers regarding the treatment of storms that impacted south-east Queensland in the week of 16 November. Our analysis as well as that of our meteorological advisers, confirms our view that reinsurance recoveries of approximately $73 million are available under the group's catastrophe cover program.

Now, the majority of the panel of reinsurers agree with that – however one of the main reinsurers responsible for about 25% of the program, does have a different opinion. Now, our aim is to have that matter resolved by 24 February but for the purpose of today's discussion we have assumed reinsurance recoveries based on the assumption that our position will ultimately be adopted by the full reinsurance panel. However, we will point the effect on earnings in the unlikely event a minimum recovery was to eventuate.

So with those comments let me turn to the group P&L. We expect the group's net profit after tax Promina acquisition items and minority interests for the half year to be in the range of $250 million to $270 million assuming a favourable reinsurance outcome. Should that favourable outcome not eventuate this same measure will likely be in a range of $210 million to $230 million. The anticipated result has clearly been impacted by an increase in provisions for bad and doubtful debts and Chris will spend some time on that in a moment. But you will also see some very positive results at the top line with strong revenue growth and good control over expenses.

In GI, you will see good GWP growth offset by the significant impact of weather events and accounting treatments. We are very pleased with the way all of our brands are performing and the progress both our personal and commercial lines business have made in capturing the benefits of integration.

Given the state of the equities markets, the wealth management division's expected result is pleasing, particularly the performance of the life risk business.

In previous presentations we've told you of the steps we have taken to make our business more resilient in these challenging times. We've worked hard to drive down the costs across the business. We've taken a conservative approach to reinsurance and to investments in our investment portfolios. In this half we are taking further steps by adding an economic overlay above our already conservative collection provisioning. These measures, along with the steps we are taking to restore and build our capital positions, will serve Suncorp well into the future.

At this point let me hand over to Chris to give you a full rundown of the divisional performance and update you on our capital position.

Chris Skilton: Thanks John, and good morning everybody. I am going to attempt to be fairly succinct during the course of this presentation, and I'm starting on slide five.

So firstly to the bank: the underlying profit growth is very strong. Profits before tax and bad debts in the range of $445 million to $455 million, which represents a fairly significant increase, approximately 40%, of the prior corresponding period. Now there are two keys drivers in this result. The first is extremely tight cost control with expenses pretty flat on the June '08 half year, and that's even after absorbing approximately $25 million of one off restructuring costs associated with the merging of the retail and business banks.

Now secondly, revenue has been stronger than expected. Obviously, there's always a lot of moving parts here, especially when it comes to net interest income, but I will draw out three prime reasons. The first point is that the majority of growth in net interest income was due to the growth in average balances for the half and as a result of the growth in lending during the June 2008 half. The second point is that during the period the bank bill rate to cash rate has narrowed as the market has anticipated and has even at times got ahead of some of the official interest rate decreases.

The final part is actually credited to an accounting issue and that's the accounting treatment of short term hedges. Now as we don't apply hedge accounting to all short term hedges, there is a difference in the treatment of the Australian transactions which are marked to market whilst the hedged position is accounted for on an accruals base. Now I should also note in that regard that the mark to market gains on short term hedges fall into non-interest income rather than net interest income and it does explain the fairly steep increase in that non-interesting income line.

So prima facie this is a very strong story, but I must stress that you can't extrapolate that 40 per cent growth into the second half and beyond, hence as John will cover off towards the end of the presentation we're still sticking to our full year guidance of profit before tax of bad debts in the high teens - increase in the high teens for the year as a whole.

Moving onto slide 6 and, as I mentioned, revenues are up strongly and part of the reason was that margins increased to 184 basis points for the half and that was up three basis points compared to 181 basis points for the six months to June '08. Now again as you know there are a lot of moving parts to margins so let me call out what I believe are the key movements. Firstly, the margin was favourably impacted by our treasury team being well positioned with a significant drop in the yield curve that we saw during the first half and that contributed in an increase of approximately 10 basis points. In the underlying margin we're generally able to pass on increased wholesale funding costs to customers through changes to product pricing and like most participants in the market, we have increased our risk premiums which I think we'd all agree and all acknowledge became far too low through intense competitive forces over the last three to four years.

Looking at the second half and we do expect a further increase in wholesale funding costs and that's based upon funding spreads prevailing at the current rates when replacing maturing facilities, but also combined with a further lengthening of the duration of the bank's wholesale liability base. Given the bank's asset mix and the continuation of the market pricing behaviour consistent with the current environment, we would still expect to be able to pass on a significant proportion of this increased cost to our customers. However, and I want to stress, the second half will be unlikely to have the tail winds that benefited the first half such as the contraction in cash to bank bill spreads and the contribution from treasury. In addition, the timing differences associated with hedge accounting would also reverse. Consequently we do expect margins to contract in the second half.

Now moving onto slide 7, the decision to reduce lending in non-core segments along with the slowing in the Australian economy resulted in lending growth slowing over the half to December with loans, advances and other receivables finishing the half at just over $55 billion and in all we now expect total lending to be relatively flat for the full year to June 2009, particularly as we progress with our strategic portfolio realignment that we've discussed in the past.

Our retail deposit growth was relatively strong, particularly following the announcement of the Government Guarantee and along with most ADIs we have seen continued strong seasonally adjusted performance in deposit gathering since 31 December and into January this year.

I'll speak briefly about wholesale funding and liquidity. This was quite rightly causing the market some very strong concerns about five or six months ago, but it is much less of an issue now. It has obviously been helped by the Government Guarantee. Now we've raised approximately $5 billion in three year term debt in the first half of the year and that's above the $3.5 billion we needed for the full year. So as a result, the average term of the balance sheet liabilities is now almost 12 months at 31 December and that's up from about 0.7 of the year at 30 June '08 so that's a significant increase. I have to say that assuming we maintain our current credit rating and I have no reason to believe that we won't, I'm now pretty comfortable as Finance director with our funding and liquidity position.

Now moving onto page 8 and perhaps the more prickly issue of the impairment chart. Now there's no question that we've seen a much faster deterioration in conditions over the last three months than expected when we came out with our update in November. However, I would also suggest that directionally at least, this is not inconsistent with what we're seeing in the rest of the sector, although we're now expecting a bad debt expense for the half of $355 million. Now whilst not resiling in any way from the fact that this is an extremely high headline number and way above previous guidance, I would like to point out that there are a number of what I might call lumpy items in there which I'd like to make mention of. The first is that we've raised a specific provision against Babcock & Brown International of $75 million before the IFRS impact. As you know, we are in the syndicate of 25 banks to the head company. The overall syndicate is about 2.3 billion.

Six months ago, B&B International had net assets of around about $2.5 billion. It was thought at the time that this was a sufficient buffer to absorb significant write-downs on underlying assets and investments on their balance sheet, in a controlled sale scenario, which would result in the bank's recovering the majority of their debt.

Now more recent information, however, suggested this will not be the case and that there will be a substantial shortfall. So having recognised the need to take a provision, we have decided to be on the conservative side of that, and we've allocated $75 million as a provision against total outstandings of $133 million.

Now, there's another item there of roughly $53 million, which is purely accounting driven. Now, what we're finding is that even on accounts where we expect to get the same amount of money back, we are pushing out expected receipt of those proceeds by something like 12 months, or even more, on average.

I think most of you probably would be aware that IFRS requires you to discount your expected realisation proceeds, back to the present day, and your provision is the outstandings less the discounted realisation proceeds. So the present value discount components of the specific provision will actually ultimately unwind over time and will come back into net interest income, either if you get repaid or that repayment expectation draws closer to where you are at that point in time.

Now, as you would also be aware, the third issue, there has been a lot of discussion and debate around economic overlays, and indeed whether it's even technically allowable under the current IFRS accounting standards. Up until now, we haven't applied an explicit economic overlay when calculating our collective provision.

But as this is now becoming apparently industry practice, we have decided to fall into line with that and take a similar approach and add an economic overlay to the collective provision. And that's $75 million. Now, I think this should be considered more of a one-off rather than the recurring item, because once you've established the base, any increment or decrement should be at the margin; unless, of course, there's a significant shift either way in underlying economic conditions.

If I move on to slide 9 and to impaired assets now, very briefly, the sharp deterioration in the global Australian economy over the half has resulted in increases in impaired assets, and particularly late in 2008. That has resulted in reduced property valuations.

Now, since we last reported to the market in November – and that was based on September quarter figures – we've seen an increase in gross impaired assets of $198 million. However, I very much point out that $133 million of that is attributable solely to Babcock & Brown. So it's clear, perhaps, the increase was a more modest $65 billion.

Now, the waterfall on the slide shows the movement in gross impaired assets from a full six month period from 1 July to 31 December, which I don't intend to go through in detail in this presentation.

If we move on to slide 10, as you can see from the slide, based on the significant increase in specific and collective provisions booked in the half, our coverage levels, as a percentage of gross loans and advances, are now comparable with the major banks.

But I would also like to point out, as I have done many times before that our lending book, despite a higher exposure to property development and agribusiness, where we hold underlying security over real property, contained very minimal cash flow lending, does not have a credit card book, and has minimum unsecured personal lending. So again when you're comparing these things, you have to be very, very careful that you take a different mix of the book into account.

On page 11, in summary on bad debts, as mentioned earlier, I thought it would be useful to call out some of the lumpy items that have impacted on our bad debts and our first half results. You can see there that the combination of the economic overlay, the Babcock & Brown impact, and IFRS, represents over $200 million of the $355 million.

Hopefully this waterfall chart gives you a reasonable understanding of the developments since our last market update. So, having said that, that clearly raises the question - what's the outlook for bad debts from here? Firstly, I want to stress that any forward-looking guidance on bad debt expense is extremely difficult and subject to many variables.

And as I stated at the Group's 24 November market update, any forecasting of full year bad debt expense at this stage in the economic cycle, whilst informed by a thorough review and evaluation, is clearly subject to volatility and change. However, with that caveat in mind, I am prepared to say that based on the most recent analysis, this current forecast is for full year bad debt expense for 09, including the provision for Babcock & Brown and the additional economic overlay that we've got in the first half, will be in the range of 100 to 130 basis points of gross loans, advances and other receivables. But I will stress again the caveats around that.

Finally in relation to banking, let's have a quick look at the banking book, this is on slide 12. The chart included in the presentation shows the split of lending book by asset class and state. Now the bank currently has total profit exposures, other than retail mortgages, of around about $14 billion. Now of that approximately $7.4 billion is in property investment and $6.5 is in construction and development.

The property investment portfolio is a well diversified portfolio geographically and across property classes and whilst there has been a significant drop in values in some asset classes, most noticeably in commercial property, serviceability has improved significantly with the fall in interest rates. Vacancy rates, whilst on the rise, still remain relatively low compared to previous downturns.

In the development finance book, less than 15% is exposed to commercial property classes, so in other words the majority of development property exposures are linked to the residential property sector.

Asset levels in the residential market have clearly been supported by the government stimulus packages and you are getting now imbalances between supply and demand, and that is demand being greater than supply.

In addition the corporate lending book is well diversified. It's a well diversified portfolio where the vast majority of the book is secured by tangible security or first rights to the cash flow from the underlying assets.

So let me move onto GI - so I'm on slide 13 - and on the basis that John explained that we did our best case reinsurance recovery from the November South East Queensland storms, we're looking at a contribution to profits before tax of between $240 and $260 million.

So I'll spend a bit of time talking about the more significant factors that have impacted the ITR in the December half, particularly GWP, claims costs and the impacts of discount rates and credit spreads on the technical reserves income.

Before I do, I can say that the good news is on shareholders funds, it's where we have a profit of about $150 million. This is a result of de-risking the book in September, by moving out of equities when the All Ords were round bout 4,900 and switching in to fixed interest to take advantage of these historically high credit spreads on highly rated paper. So that was a good strategic move at the time.

If I now turn to GWP on slide 14. We now are definitely seeing the benefits of price increases in the premium lines as we do continue to focus on price rather than volume, so total GWP will be up around 5.9% on the prior corresponding period. Now, of course it varies across product, but to just give you a broad idea the merger will be up about 4%, home up a pretty impressive 9%. We've talked about the commercial cycle beginning to harden, and you can now see the evidence of that in a 9% increase in that portfolio.

CTP is up 4% and in fact the only class that is down about, but not as much as in previous reporting periods, is workers compensation and other which has decreased by 5%.

So look, I think overall this is a good story here and clear evidence of the underlying strengths of the brands, but also that we are now in a hardening market insurance cycle.

Now for the impacts of major weather events, on slide 15. The first half saw claims costs that were around $60 million in excess of our budgeted allowance. This slide illustrates the net impact of the various storms, assuming our base case for the November South East Queensland reinsurance recoveries occurs, and that was the one that John outlined.

So you can see we are assuming that the net costs of those storms are $125 million. However, if we recovered the lower reinsurance amount, then the net costs for these claims would increase by $185 million. So there is a $60 million swing between those two assumptions.

The other important thing in this regard is we do have an aggregate cover which protects against multiple events, now I've spoken to this many times before, but just briefly once the accumulated losses - and that's less $10 million per event which we have to chew up – exceeds $250 million we start to recover under the aggregate program. Now based on the current understanding of south-east's Queensland storms there were two events which with a deductible of $10m each, would consume something like $105 million of the aggregate cover deductible.

If the SEQ storms, do end up costing $185 million net of reinsurance, this would still be two events but actually two different events. We would actually have a contribution to the aggregate cover of something like $165 million. Now if this occurs, although it would impact the first half P&L, obviously it provides a huge amount of protection and limits the amount of storm damage that could occur through the P&L account in the second half.

Now another issue, moving to slide 16, I need to call out is the effect of movement in credit spreads in the yield curve that cover our technical reserves. Now, the top chart shows how discount rates have fallen as at 31 December 2008 compared to the previous half year's results. And this has had an impact of around about $550 million on both the claims expense and investment income because the assets and liabilities are generally matched for duration. So they've been immunised and basically matched off.

However, the second chart shows the impact of credit spreads. In the past six months, the widening credit spreads have reduced investment returns by an estimated $200 million.

Now, many of you who watch the markets would be aware the spreads moved out significantly in mid-December as major banks and perhaps, one major bank in particular, issued guarantee paper to the domestic market, in what appeared at the time to be unusually wide spreads, and that had a negative effect on the whole market.

Now again, I would stress the fact that this is a timing difference which will reverse in the future either by spreads moving in, as indeed they have begun to do in January, or as the underlying security matures. So at some stage that money does come back through the P&L.

If I can now move to the ITR, slide 17. Previous guidance, as you know, from the year as a whole was between the 10 and 12 per cent ITR. Now, the actual ITR for the first half is going to come in at between 4.5 and 5.5%, so let me take you through a very high level reconciliation between the two. Now firstly, if you add up all of the storm events and we get the expected recovery on the reinsurance, it will still be $60 million above our amount of $120 million for the half. So it would come in at $180 million compared to $120 million.

I've already spoken about the credit spread impact, and as I said that was around about $200 million. The third is releases. Now we've talked previously about structural releases running out, which is true, perhaps with one exception which I'm going to come to in a moment. However, what we would consider to have been normal releases of approximately $100 million in long tail in the half was offset equally by new business strain.

So yes, we've had a release on prior years but the business that's written in the current year has an offsetting strain. Now this was largely anticipated and we had talked about this and foreshadowed this effect in previous presentations.

Now an exception which I alluded to a moment ago is that we have benefited by almost $80 million by a reduction in the average wage inflation assumptions of 4.5 per cent and 4 per cent in all long-tail portfolios. Now this was very much driven by the actuarial profession, not just our actuaries but I think that's pretty common across the whole industry, and it does reflect the changing view of future economic settings forecast over the next few years.

Now, quite frankly, whether or not it's called a structural release is somewhat irrelevant. I think the fact I'd make is more the nature of one-off benefit, rather than sustainable income growth.

Now we look at the reconciliation that we normally put in our results announcement and take all of the issues I've just talked about into account, you do come to an ITR of between 11 and 12 per cent. Now, that's very much our rationale, saying that the business is still performing well despite the headline number. But I will also stress, as I always do in the half-yearly and yearly presentations, that this is not a formal normalisation as far – earnings by the company, and there are many other factors that could be taken into account.

Now, moving to – and I'm going to be extremely brief here – the contribution after tax is a strong $135 million. Now this has been achieved with good life risk sales and strong expense management, but offset not unexpectedly by falling funds under management which has obviously restricted fee income.

Now, in terms of investment markets, the impacts of discount rate changes on life risk DAC has more than offset the impact of falling equity markets, and hence the result is perhaps stronger than some people might have been expecting.

So those are the businesses and finally on page 19 and 20 I'd like to turn to capital.

At 31 December '08 our CAR or capital adequacy ratio is relatively strong at 10.67%. Our tier one is also relatively strong at 8.83%. However that is marginally below our revised target range which we've now set at between nine and nine and a half per cent. We're also likely to have an MCR for the General Insurance Group of around 1.65, but given the uncertainties regarding the reinsurance position, the Group has not made any allowance for a GI dividend in determining the bank's capital position.

Now the key ratio and I'm moving on to slide 20 is clearly ACE and some of the issues I've already talked about have clearly had a negative impact. Now I indicated in previous presentations I think both of the full year last year and in November but I thought it was reasonable to expect an ACE to be at around about 5% at this point in time. Now we are looking at an ACE figure of more like 3.9 per cent, so it's important that I explain why that's the case. Now obviously the reduction in income in the bank as a result of a significant increase in bad debts, had a direct impact on ACE because of lower earnings and that contributed about a 30 basis point reduction. In addition, risk weighted exposures increased slightly to approximately $43 billion because there is very little refinancing occurring in the market at the moment and so the runoff in risk-related assets is slower than we had anticipated some six months ago.

Now next, a combination of increased impairment charges and unrealised losses on mark to market hedging positions means that for the first time and certainly the first time I've been in the company that we now have a deferred tax asset rather than an interfered income tax liability on our balance sheet. Now whilst this has no impact on the P&L account, unfortunately deferred tax assets have to be deducted from core capital for regulatory purposes and its impact was a negative 50 basis points.

In the GI we did indeed complete the restructure of a group that we had talked about for a while which we anticipated would release $150 million of capital. In addition under the normal course of business we would have expected our further dividends to be upstreamed from current period earnings. Now as I mentioned a couple of minutes ago, we are actually upstreaming no capital to the bank. Now one of the reasons why that is, is regardless of normalisation and timing differences the fact is our reported profits on the ITR are more like $150 to $160 million than the $340 to $350 million that we might otherwise have reported.

The other aspect which might have missed a few people is to do with the significant reduction in discount rates. Now whilst that doesn't have much impact on the P&L account, what it does do is actually grosses up your assets and liabilities and therefore the capital you're required to hold is higher because that capital is calculated primarily as a percentage of that asset base and liability base.

Now some of the items I've talked about will turn around in the future. We have a profitable ongoing business and I would expect the deferred tax asset to eventually be realised. The credit spreads at some stage will move in and indeed have begun moving in January and at worst you get them back when you hold those securities to maturity. However, in this climate in particular it is very difficult to estimate when those timing differences may reverse with any degree of certainty and hence when the associated positive capital impact will reappear.

On that note, I'll hand back to John to complete the presentation.

John Mulcahy: Thanks Chris and if I move to slide 21 in relation to our guidance for full '08/'09 financial year and clearly at the macro level we expect conditions will remain challenging and economic activities subdued over the short to medium term.

In the bank we expect that that reduced economic activity combined with a strategy of refocusing on higher value relationship portfolios and actively running off our non-core portfolios, will result in gross loan advances and other receivables continuing to slow over the remainder of the '08/'09 financial year as well as throughout '09/'10. Therefore we now expect lending growth to be flat compared to the '07/'08 year and beyond that the pace of balance sheet contraction will be determined by the extent of refinancing opportunities available across the industry.

The bank is on track to achieve its full year forecast growth in profit before tax and impairment charges in the high teens. However as Chris outlined, a combination of moderating economic growth, higher average funding costs and portfolio realignment and contraction will lead to reduced revenues in the 09/10 year. The bank's expenses will continue to benefit from structural changes implemented during the first half, and ongoing tight controls over costs and discretionary expenditure.

The depth and pace of economic deterioration, and the offsetting effect of government stimulus, continues to make forecasting impairment charges extremely difficult. As stated at the group's 24 November 2008 market update, any forecasting of full year bad debt expense at this stage of the economic cycle, whilst it can be informed by thorough review and evaluation, is clearly subject to change.

Therefore, based on the group's most recent analysis, its current forecast is that full year bad debt expense for the year to June 2009, including the provision for Babcock & Brown, and the additional economic overlay, will be in the range of 100 to 130 basis points of gross loans, advances and other receivables.

Moving on to General Insurance, Suncorp expects growth in gross written premiums will be the previously forecast range of four to six per cent for the year to June. Whilst it is impossible to predict the frequency and severity of major weather events during the second half, the group's reinsurance programs will support earnings should weather events exceed its usual allowances.

Assuming weather events do remain within normal allowances in the second half, and no further widening of credit spreads, the group is forecasting a second half ITR in the 10 to 12 per cent range, including integration benefits.

Wealth management will continue to be impacted by volatile fixed interest and equity markets. Although it is difficult to anticipate with any certainty the full year result for wealth management, Suncorp continues to target a flat underlying profit after tax for this financial year when compared to the 07/08 year.

The Board's intention is to declare an interim dividend of 20 cents per share, fully franked. And it is targeting the same amount for the final dividend, subject to achieving its forecast, from the guidance, and any necessary regulatory approval. Beyond this financial year, the Board is targeting a dividend payout ratio of 50 to 60% of cash earnings. Of course, any dividend guidance is subject to the capital requirements of the business, regulatory approvals, and general business and economic positions.

So that's the end of the formal part of the presentation. I would like now to proceed to question and answer. But just before I do, I need to reiterate that, as I mentioned earlier, for US legal reasons, we can only discuss the items contained in this market update, and cannot discuss our proposed capital raising until we conclude this part of the session and then start again on the capital session. So I'm pleased to take questions.

Question: I just want to actually go into more detail around the Tier 1 target range of 9 to 9.5, being exceptionally high relative to where the other major banks are running, and also relative to where international banks are running if you adjust the differences between obviously what we're doing in our market and the way that other banks account for capital as well. Is this based on your ACE, or is this another reason that you think the bad debt environment is likely to get significantly worse?

Chris Skilton: No. I think the key reason is because of the shape of our group and we have such a large investment in subsidiaries, particularly GI, which gets deducted from capital. If we run an ACE of six per cent, naturally we would run higher Tier 1 and CAR ratios. Now, rightly or wrongly, it would appear that the market is really looking at a 6% ACE ratio as being the target. That naturally leads us to a higher Tier 1 and CAR ratios.

I would say though that in this environment, personally I would rather be on the robust side of those ratios, which really does allow you a significant buffer against potential downside risks, without any risk coming back to the market. I think if you go once on one of these that you really don't want to have to come back to the well.

Question: This is an issue with your business mix, with banking at 20% of the group. So how does that fit in the mix? You're looking at obviously having to hold more capital in the bank than what you were under the GI. Can I just get an idea as to where you sit now with the bank? Is that up for sale, or is it part of the core group?

John Mulcahy: It's not up for sale. We're going through this capital raising to make sure we've got robust capital positions in the bank, the General Insurer and the Wealth Manager. And we think that that will give us good opportunities to make sure the bank performs strongly as we go forward, and is robust to perform in what is deteriorating economic circumstances.

Question: So you don't see the fact that you will have to substantially hold higher capital than your peers

John Mulcahy: Well, at this point in time, we clearly are targeting very strong capital ratios because it's a deteriorating environment. That's not to say that we need to hold those ratios as the environment starts to improve.

Question: Firstly, a quick one just on your full year market guide of the 10 to 12. Can you just confirm what you're assuming in terms of storm events in that period?

Chris Skilton: We're assuming in that, $120m normal storm allowance.

Question: I'm just trying to get my head around the bad debt guidance for the full year. Also the speed at which you say the increases of bad debts in terms of if you put through in the first half some things like economic overlay and yet you're expecting the same number for the second half, so I'm just trying to get some feel for, one, what changed your view in terms of putting the items in and, secondly, what's happening in terms of deterioration in the second half, or what you expect to go forward.

Chris Skilton: Let me talk about the lower end of the range. Don't read anything into that but 355 in the first half you'd be looking at something like 200 in the second half. Now that is a crude way of doing that, taking out Babcock and Brown and economic overlay and then you get a similar result in the second half than the first half.

Question: If I look at the impairment, and you only increased that by 75 per cent in the half year, I'm also finding it very difficult to understand why you're still saying you've such a large charge in the second half, and if you are referring to unknowns that may come up, it just seems overly conservative.

Chris Skilton: Well look, how do you answer that? I mean, we thought we had a reasonable stab at it three months ago and what happened? I will stress, you know, the actual outcome could be a wide range. I mean, all we're getting here is guidance on the basis of information that we have at hand. We are assuming that we're not at the top of the cycle that we think's going to peak in '09-'10, so you are going to see a gradual deterioration. We have done a lot of work, particularly on the major exposures in our book, but I think what you begin to see in the second half leading into '09-'10 is perhaps a more broader deterioration overall. But you know, it's a very inexact science at the moment.

What I would say and am prepared to say, and I've said this consistently, is when I look at our book compared to the majors I still believe over the full cycle that we will end up with a charge that will be in the order of 30-35% less than the majors. What no-one can really, really form a view on at the moment – and I stress that's over the cycle and not any discrete period – but what is very difficult to gauge at this point in time is what are the total losses going to be over the cycle. Some people have retrospected '91 but I think this is very different to '91 for many reasons. But that is the challenge here.

Question: You mentioned earlier that refinancing has grown significantly. Can you just comment on what we're likely to see in that development finance book when we see the results. Has the rate of amortisation there slowed significantly?

Chris Skilton: It is slow. I think, roughly, it will be flat at the end of the year, probably marginally down at the end of the year. No, I think in '09-'10 you'll see it amortised much more rapidly.

Question: Just a final quick question, that inflation adjustment, it did look quite low for half a per cent adjustment today, your sensitivities indicate that one per cent should be closer to a $230 million adjustment figure. Is that something you can explain and can you also just comment on the outlook there, like further deductions in your inflation assumptions.

Chris Skilton: The first one I cannot answer off the top of my head. I'll get back to you as soon as we can. In terms of further reductions, we tend to move these infrequently. If you recall about two years ago in fact there was some possibility of actually taking it up half a per cent, so we actually expect to have something degree of certainty for the next three or four years.

Now, I think having moved it down to 4.5 my proposition would be – and I'm not an actuary, that they would wait at least 18 months before they moved it again. If you want a benchmark though, minus that is MACE calculations have a figure of about 2.7, 2.8. So the feeling is that that is still conservative.

Question: I've got two questions, one on the bank and one on the general insurer. Firstly on the bank looking at your pre-bad debts guidance of high teens, that's consistent with previous guidance, given that in the first half it looks like that was due to the hedge accounting, when I actually back out what that means for the second half, it actually suggests the second half's profit of pre-bad debts of only 325 to 350 which is back in line with the previous year. Is that correct, are you expecting underlying contractions?

John Mulcahy: Well certainly the second half is going to be lower than the first half, I'm not going to quote numbers and I'll just refer back but the 19%. We certainly don't expect 40% in the second half. But I did outline, some other reasons there, particularly we've seen, most of the movements between cash rate and bank fills come back in and that's been a benefit for the whole industry, which we wouldn't expect to be repeated.

I think the other key factor too is that the amount of debt raising that we've seen at the end of last year to the beginning of this year, you're really going to see the impact of that flow generally into not just our P&L accounts but the banks P&L accounts generally.

Question: I guess the crux of the question is, is it correct to just use that second half implied as the new base or is there some element that is unusual in there, for example are you assuming any reversal

John Mulcahy: No, no, I think the honest answer to that is probably the first half is more of an aberration. The second half is probably a more realistic base if you're looking at trying to get into 2009/2010.

Question: The second question is just a slightly different topic on the general insurer, the one line that is confusing me a little bit is I'm just looking at the expenses, operating expenses for the general insurer which should be the least noisy line of the whole lot and I just note that this is post integration savings. In 2H last year you had $828 million of expenses and your figure for this first half is $830 to $860 million, which is supposedly post integration.

John Mulcahy: The movement there, and it is a bit of noise, is primarily due to the liability adequacy test and that moves into expenses. The LAT test this year was a negative for a charge of about $40 million. I think last year there was a small credit, so I think the turnaround round is about $60 odd million between the two years.

Now when we do the full year presentation, we will actually pull that out. So it's not underlying operating expenses.

Chris Skilton: We can actually pull it out for the half year.

Question: I've got a question on the bad debt situation. You've got $1 billion in bad assets and in June you had around $250 million of loans 90 day past due. So the first question is what's that number now?

That's versus $500 million of provisions in the book, you've got about 40% coverage on those numbers that I can see. In this environment you could argue you'd want at least half a billion dollars of capital up your sleeve and that's basically what you've got . Is what you're raising enough? That's the second question.

Chris Skilton: I am comfortable and am confident in saying that 900 is enough.

The 90 days dues have gone up to $450 million, but when you're looking again at our coverage against impaired, I really must stress again – I know I do this repeatedly – but the shapes of the book between us and majors is very, very different. We are generally secured and when you take into account the majors, particularly their credit card books which have been showing high probability of defaults and very high loss given the defaults environment and their personal loan books would also be rising.

Also when you look at the majors, I do look at these differentials between the two that have large institutional banks and the two that don't, and again that reflects the nature of the unsecured corporate loan books which have again much higher given default rates.

So when you're playing with ratios and trying to compare us to the majors, I think that can be a little bit dangerous. I mean we try to do the same thing as a bench mark. It's quite hard to do. But you can't necessarily assume that just using average ratios that we're not provided, in fact if you look at CBA and ANZ, ANZ's got twice the coverage CBA, do you necessarily draw the conclusion that CBA is under provided by 100%? You may, I don't know, but it's - using averages is, I think, fraught with danger.

Unfortunately when we try to do it, and it may be the same for you, that there is not enough published segmented data to really try and do a decent bit of analysis.

Question: But your run rate in terms of loss to assets is now as high, if not higher in some cases. So I guess looking at the books through a cycle might be interesting. Right now we've got a situation where this has come upon you over the last quarter, so I'm just wondering how confident you are that you've got enough capital?

Chris Skilton: Well again, I'd also say to that, that as I said in the presentation, there's almost $200 million there what you might call non-recurring items. Now I hesitate with Babcock & Brown, I mean that's a genuine loss. But I wouldn't necessarily expect another one of those. So I'm not looking at that first half charge as necessarily being representative of ongoing charges.

My simple answer is, yes I do think we have enough, because remember, especially with our dividend payout ratio, that we are, under normal circumstances, going to generate more retained earnings as well.

Question: Just a follow up question Chris, you mentioned earlier that you're confident your credit rating won't suffer from this, Standard & Poor's downgraded you early January by a notch, prior to having this particular information, what makes you so sure they won't revise their thinking?

Chris Skilton: Basically the size of the capital raised and the assumption that makes us extraordinarily robust in terms of capital ratios.

Question: Just a question on bad debts firstly, when you talked about if you back out economic overlay and B&B, you're still talking about a basis points charge of somewhere around 75 basis points which is well above previous guidance. The key item seems to be IFRS present value, is that something that you weren't aware of at the time? I would have thought that you'd have been familiar with that or is it because it's giving customers an interest rate holiday or something that you weren't anticipating to do?

Chris Skilton: No, it's not interest rate holidays. It really is reflecting the current market and I would stress that really it did get a lot worse from last year and sliding into this year. But it is that we're really pushing out now - it's not just about the realisation of assets.

So the market is very slow, there's not very much refinancing going on. You'd be aware that there are not that many sales in the commercial property market. So the assumption is that those assets are going to be held for longer for us because of the way you discount these things back, that can have quite a significant effect.

But I also mention that someone asked me the other day, using a discount rate of 3% or 4%, now if you have to use the discount rate of the underlying interest charge on those accounts, some of those can be as high as 10%, so discount factor actually is quite large.

Question: Okay, so when you're looking at that commercial property portfolio. Even though you mentioned that rates are coming down, they can see rates have come off a bit, but presumably the coverage is still pretty robust. What's your approach to that, despite the fact it's poor asset values? Do you actually hold firm on those loans or do you force them to crystallise in a deteriorating environment? How much flex do you have on that commercial property portfolio in terms of realising bad debts?

Chris Skilton: Okay, well it's very much horses for courses, so I wouldn't say that there's a homogenous answer, but certainly with the interest rates coming down, absolute interest rates coming down, it is making serviceability for a lot of developments that much easier.

Again, if you go back to '91 which some people have tried to compare it with where interest rates were 18% and cash rate was 18% and borrowing rates were sort of 22/23%, that's a very different scenario to when you've maybe got a cost of 6% or 7%. So a reasonably well capitalised developer, with those sort of service levels is finding it much easier in this cycle than in the past cycles.

So for us, actually, servicing is the most important thing when we're looking at these types of accounts.

Question: Just turning back to the hedge effect in the non interest income, you mentioned that was a benefit in the first half of '09 but you mentioned it might be a negative to the margin in the second half of '09. Did I miss your comments?

Chris Skilton: Yes, well that's absolutely right because essentially when the hedge accounting came in under IFRS, it was very onerous to comply with in internal accounting. We took the view that anything under 12 months would be mark-to-market and not accounted for hedges.

Now, when interest rates aren't moving around very much, that's not terribly material. But with the change in the ilk, you have to mark-to-market the hedge, so you bring a lot of income in, and that comes through your non-interest income account. But, of course, the assets against which your hedge is accruing, and it's accruing basically if you've got a 12 month hedge over the next 12 months.

Now, more of it will reverse in the next 12 months, in the next 6 months, and most of it will reverse in the next 6 months. That's asymmetrical accounting. I hate it, but it's the accounting standard.

Question: So when you're looking at your revenue profile going forward, and you talked about second half revenues being down, hedge accounting is going to be one of the negative things about it, and also the fact that your balance sheet is probably likely to contract half on half. What's your approach on costs?

Are you able to pull costs more aggressively? And when you're looking in 2010, when you're actually facing a negative revenue growth profile year on year, are you able to pull costs hard enough?

Chris Skilton: Well look, I think we've demonstrated through these numbers, if you look right across the board, I think our cost control has been excellent. Remember I said that in the current half, even though we were flat in the previous half, we did absorb $25 million worth of restructuring costs. So that sets the run rate going forward – here's $25 million less than what you've actually seen in the P&L accounts.

So we believe we're pulling all the levers. I have to say, having been here for going on eight years, we now have in my view a truly very focused, cost-conscious culture. But I think, at the same time, that is not ignoring that you reinvest in core projects. For us to invest in a project now, it really has to be a plus to have, not a nice to have, and it really has to leap quite a rigorous hurdle that it jumps over.

But I only make that point because I have been in organisations that turn the investment tap on totally, and of course they then hit problems three or four years down the track when that comes home to roost. I hope that answers the question.

Question: Can you be more clear? So would you be willing to have negative draws on revenue growth versus expense growth in 2010? Or is that something that you would avoid at all costs?

Chris Skilton: All I would say is that I think, as a previous caller mentioned, that the trajectory should ease off more in the second half of this year rather than the first half.

Question: Just one more question with capital: what was your latest on the ACE position with S&P?

Chris Skilton: I think it's very true to say that S&P is still putting much more emphasis on ATE than ACE. The thing about ACE, and why six is important… Actually, the market has gotten very used to using ACE as a benchmark, even though it's sort of an S&P benchmark.

You know, I've created arguments forward that if we maintain a similar ATE to the industry that should allow us to run a lower ACE ratio. But unfortunately in these times, people are being pretty basic, and I think that your benchmark for ACE is expected to be six.

Question: Firstly, can you tell us what LGDs you're factoring in on your development finance exposures for constructing your specific provisions?

Chris Skilton: We're not going into that detail because, again, it's not a simple question. All I can say is that our LGDs, which is important, they're not based on historic experience. They're based on the current economic environment that we are in today, which is indeed what the standard requires of you.

Question: To make an observation, they look to me less than 30%. Is that a fair comment?

Chris Skilton: I'm not going to comment on that one.

Question: Let me ask you a different question then. On that DAC adjustment in wealth management, the life risk policy liability discount rate change is over $100 million. You said it's related to the DAC. I didn't really understand what that's about. Is that because discount rates have gone down, so the value of the liability and the deferred assets associated with it goes up?

Chris Skilton: Yes, you've got it absolutely right.

Question: Okay. So that's a one-off potentially?

Chris Skilton: Well it's a one-off if you don't expect the same sort of movement in interest rates to occur.

Question: Yes well it's based on the Government bond rate?

Chris Skilton: Yes it is.

Question: If I could just get you back to slide 14 where you show your gross with premium.

Question: Just on slide 14 your gross premium, I'm just trying to get behind it - timing differences or when policies roll over and you talked about higher deductibles, I just kind of want to know what's happening on the pricing front across those portfolios and what they're likely to look like in the second half?

Chris Skilton: Well we're continuing to put price increases through generally, particularly on homes and particularly on home buildings rather than home contents. Those price rises are quite strong. Motor I think has still tended to be around about 4 to 5% per annum. CTP is continuing to go up. The challenge there though is that when you're at this stage of the cycle premium increases always lag claims experience. I think we talked before about how we benefited for many, many years when you got an improvement in claims costs and premium decreases lagged it, but unfortunately on the other way of the cycle there is probably about a six to nine month lag. Now the good news though is I have to say that MACE is very much aware of that. They still want the scheme to be profitable but I'd also say to be honest that I don't think the regulators are going to be very reluctant to let the industry make the sort of almost super profits that we made two to five years ago. Commercial is a blended rate there. Certainly I think we can say now that all the insurers are moving to put commercial rates through. Look the one area that is not that profitable at the moment is probably SME area and I'm talking about the industry as a whole because there has been some deliberate cross-subsidisation in the liability classes, but that now is one where the whole industry is beginning to push the price increases through to try and get I think a reasonable technical return on that particular product. So we are still seeing reasonable increases going through and one of the reasons why is with interest rates coming down the running yield on technical reserves is obviously going to run down over time and so one has to compensate for that as well through price increases.

Question: So what you're saying is we're looking at volume increases or decreases. You talked about the deductibles, but would the average price increases be higher than the numbers?

Chris Skilton: I wouldn't go as far as that. I think these may be reflected in what you might see in the short to medium term future.

Question: Oh one other thing - is the chairman available just to talk about the whole CEO process?

John Mulcahy: No he's not here at the moment. You can only question myself.

Question: Back on to the earlier questions on adequacy of provisions. If I look at your collective provisions to non-housing lending, I'm estimating that they're sitting around 90 bps versus the majors which are now between 105 and 160 bps and that's despite you putting that economic overlay in place. So again, I'm dragging back to the adequacy of provisions while we can be comfortable but there is now enough in the provisions and perhaps in the context of that question and you talked about what you've done with GRCL as well?

Chris Skilton: I think there are two answers to that. Again I'm going to revert back to the fact that the level of security that we hold versus the majors. And regarding the second question, well if you go back to when GRCLs were first introduced and APRA said that we're not going to allow you to eliminate general provisions just like that. We think regardless of accounting standards you would have a minimum 50 basis points. Then they said, which is a bit of tautology that to the extent that in your collective provision you can prove there was a general provision you could offset that against the 50 basis points. Now the fact is that the overlay and everybody's overlay is being treated by APRA as an effective general provision and therefore we have netted that off the GRCL – we've left the GRCL at 50 basis points therefore there has been a reduction in the GRCL that partially offsets the increase in the collectives.

Question: Just in terms of the spread impact on the GI I must say I'm a little confused by the level of impact. I looked at AAA and BBB spreads for the second half of the year and I've got them expanding 15 and 30 bps respectively. If I look at the spread expansion in the first half of '08 it was 56 bps and the second half was 32 bps, and the charge in '08 was 140 million. So I'm really struggling to understand the extent of this reconciliation impact.

Chris Skilton: Look, what you might be missing, and I'm quite happy to have that discussion later, but there are two actual components to the split differential. One is actually the split between BBSW and the government curve. That in itself moved down and of course then credit spreads are based on BBSW. So the impact is actually a combined effect of those two when you're looking at the difference between what you're holding in an asset versus the liability that's just purely the government curve.

Question: The next question relates to what you were referring to before. It's the LAT charge. My understanding is that's an increase in the write off for the DAC basically which is driving that 40 million, but it's implicitly saying that your unearned premiums are not meeting technical returns. So I wonder whether you can help us understand why your unearned premiums might not be meeting technical returns and/or which classes of business are for not meeting technical returns.

Clayton Herbert: The reason for the liability adequacy tests failing there is because of the drop in the Commonwealth Government security risk-free rate that is used to measure the premium liabilities; the value of those premium liabilities increase significantly just as the value of the provision pre-outstanding claims increase significantly.

What that does mean is that the premium for the liabilities that will come on board is the unearned premiums at a much higher rate and therefore at a loss. So in effect, that LAT test is bringing forward, that dynamic – the impact on the discount rates on the profitability of classes. The impact is much larger, of course, when you go out further in terms of duration, so what's driving that are your long-tail classes and obviously in our case the largest is the CTP book.

John Mulcahy: Guys, we're going to take one last question because we do need to move on to the capital raising details which is basically a separate session, so is there any one last question?

Question: Just wanted to see if you could make any comment about the level of capital in the wealth management business, in particular life books; whether there's been any adjustment there.

John Mulcahy: The answer is yes. Given the fall in the equity markets we have in fact made sure we got the appropriate capital in there. I think we've added about 60 million.

Question: So that's despite the benefit of the DAC uplift which would go through to capital?

Chris Skilton: Yes.

Question: Just looking at the annualised return on technical reserves, if you add that $200 million benefit back in you're running yield is 10% or just above. Shareholders funds was exceptionally strong as well. Is that your short-term expectation and that would continue in the second half and perhaps into FY10 as well, notwithstanding obviously the reduction in both rates that we've seen?

Chris Skilton: No, I think that the duration of the book is across the term. Absolute rates are coming down, so clearly underlying yields are going to begin to reduce over time. Also I think if you look at the shareholder funds; also as you replace securities – I mean, sure, they're going to be replaced at that lower rate.

So it will be delayed in terms of it will be behind and lagging the reduction in cash rates but ultimately those running yields are going to gradually come down. What you have to do, and what we have to do, is compensate for that in pricing.

John Mulcahy: Okay everyone, thank you so much for attending.

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