Start of Transcript

Chris Skilton: Good morning and thank you all for joining us at very short notice now. With me I have David Foster, who you know is GE of Banking. We also have Anthony Rose, who is CFO of Banking and Clayton Herbert, who's Acting Group CFO.

As you are aware, we are required as part of our Basel II Pillar 3 reporting to update the market on credit quality and capital issues now on a quarterly basis. But given the interest around this, we have provided some additional information, over and above the required tables that are attached, and I'll talk to these slides and will provide an opportunity to ask questions at the end of the presentation.

I'll also provide a brief update on the progress of our legal entity restructure towards the end of the presentation.

But I would make the point that David Foster recently presented at an investor conference, and provided a detailed strategic update around the bank and particularly our de-risking strategies. So I'm not going to be going over those again. However, we are happy to take questions on that subject at the end of the session.

One of the slides that David did provide in his presentation was the March 31 breakdown of our asset mix, and this is included again on slide 2. So in total, Suncorp still has around about $55 billion in total loans, $38.2 billion of that is now classified as core lending and $16.8 billion is the non-core run-off book.

Now one of the points that David made, and it is important to restate, is that there will continue to be drawdowns against our non-core development finance portfolio, and in fact the portfolio marginally increased in the last quarter to March 31.

Now while it is obviously difficult to accurately predict the level of repayments, drawdowns and refinancing activity in aggregate, we do believe the size of the non-core portfolio in general and the development finance book, in particular, have now reached their peaks, and will begin to amortise and the balance sheet reduce from this point in time.

Moving to slide 3 and our impairment loss, the total charge of $136 million for the quarter brings our actual year to date impairment charge to $491 million, which includes obviously the $75 million economic overlay we took in the first half.

This represents 115 basis points of total lending on an annualised basis, assuming you don't annualise the economic overlay. So pleasingly, what we have seen through quarter 3 and into quarter 4 has largely been in line with our expectations, following the detailed review of our loan book. With provisioning levels being largely driven by reduced valuations on existing impaired assets, as opposed to new unexpected impaired assets emerging.

But I must make the important point that in accordance with our normal practice, we will be obtaining a number of revised valuations during June. And this, along with a continued economic deterioration, leads us to the view that our full year bad debt charge is likely to be at the top end of our current 100 to 130 basis points guidance.

However, given the uncertain economic outlook it would be foolish of me not to acknowledge there has to be some downside risk to this outlook. We therefore feel it prudent and appropriate to adjust our full year bad debt guidance to 125 to 145 basis points in order to reflect that downside risk.

Now even though we are just five weeks from the end of this reporting period, I must stress that the usual guidance caveats must apply, and that is, there can be no guarantee that we won't be impacted by an unexpected large exposure, or that a combination of other factors, either domestic or global, will be beyond reasonable predictions.

To impaired assets now, which are on slide 4. I've updated the waterfall chart of impaired assets to show the contribution from each of the core and non-core portfolios. I would make the point again that we haven't experienced the large single name impairments that impacted us in the first two quarters of the year. What we have seen is an increase in smaller accounts and this has primarily contributed to the $255 million increase. And of the impaired asset balance, 82% are in our non-core book with the majority continuing to be in NSW.

Specific provisions have increased to $301 million, and I think it's worth pointing out that over 80% of those specific provisions relate to the non-core book, primarily in the Development Finance and Corporate segments.

And to the Collective Provisions, this has increased to $286 million, which again includes the $75 million economic overlay that we booked in the first half.

Now to funding and the significant de-risking activity we have undertaken in lengthening our balance sheet, which of course is aligned to our decision to identify the non-core lending portfolio and place it into run-off.

As you will know, we have increased our liquid assets ratio from 12.5% to 18.3% through to the end of April. We have completed approximately six and a half billion of term funding since January, which has lengthened the weighted average term of liabilities from 0.69 years to 1.33 years during this financial year. We have significantly reduced our reliance on short-term wholesale funding with a balance net of liquid assets now at 11% of lending, which is down from 27% at the start of the year.

Now there is no doubt that funding markets are continuing to thaw as debt market sentiment improves and confidence in the global financial system is slowly restored. But investors obviously remain extremely cautious and wary of future shocks.

The Government guarantee has definitely provided good access to global liquidity and this mechanism is being widely used now by all Australian banks. Unfortunately for the regional banks, debt investors are still differentiating between AAA rated Government guaranteed paper issued by major banks and AAA rated Government guarantee paper issued by regionals banks, such as ourselves. So when coupled with the differentiated fee scale applied by the Government, this puts sub AA rated issuers at a distinct disadvantage.

And this funding disadvantage will be further compounded as AA rated Banks raise non-guaranteed funding at lower all up cost than guaranteed issuance, as they have done from domestic sources and, more recently, I think NAB has been the first bank to issue on a non-guaranteed basis in offshore markets.

So this with our de-risking strategy will obviously have an impact on margins in the second half of 2009, and I want to reinforce our guidance of an increase in banking profit before tax and bad debts in the 'high teens'. And when I say that, I do mean the 'high teens'. I would like to emphasise again that the base for calculating that guidance does not include the non-recurring gains on the sale of the credit card portfolio and the VISA shares that were booked in 2007 and 20008. In other words, to be more precise, the base we're working off is $668 million.

It's also been suggested that the recent capital raisings will improve margins in the second half, however, the benefit of the $1 billion raising will be more than offset by the additional costs we are paying for long-term wholesale funds and the interest not brought to account on non-performing loans.

And finally on the Bank, in the APS 330 disclosures we have updated our capital numbers for the March quarter.

As we've spoken of previously, the Board has recently increased our internal targets for capital adequacy from between 10-10.5% to 11.5-12%. And following February's capital raising, our capital ratios have been well in excess of revised internal targets and indeed our banking industry peers.

So at the 31st of March our CAR is sitting at 13.24% and our Tier 1 capital ratio is 11.39%. The ACE has also significantly increased to 6.3%, which again is well above our long term target range of 4.5% to 5.0%. Additionally, we're also going to benefit from the decision to run-off the 'non-core' portfolios in the Bank. Almost exclusively those assets involved have risk weightings of 100%, so when complete, the $16.8 billion in non-core portfolios will further contribute to this strong capital story as that portfolio runs off.

Now finally at this time, I thought it might be useful to provide an update on the progress of our legal entity restructure. At the time of the merger between Suncorp and Promina, we had approximately 150 entities that were brought together. The LER programme commenced in 2008 to facilitate the simplification of the agreed optimal corporate structure. And the guiding principles have been to restructure corporate entities to align according to the governing business unit management structure, and reporting lines.

The benefits broadly are that we get greater transparency of accounting and reporting, we get improved administrative efficiency, it's easier to comply with APRA and other regulatory requirements. Probably most importantly it adds flexibility to our capital management, and it certainly happens in the rationalisation of licensing across the group.

Now the first stage of the group legal entity restructure was completed in December 2008. It brought together the GI lines of business and it allowed capital that had previously been trapped within Vero, to be available to the Group. We're now well into the second stage of the LER, which involves aligning all general insurance and wealth management subsidiaries and this is on track to be completed by July 2009.

In addition, related activities to streamlining accounting, management reporting and other financial systems across the Group are well underway, and this will further enhance management oversight of the business as well as statutory reporting.

Now I should say as part of the final stage of the LER process, the Board has approved further investigation into the legal, logistical and operational impact of establishing a Non-Operating Holding Company or a NOHC, as the listed entity owning the Banking, GI and Wealth Management subsidiaries. Now while the Board believes a NOHC structure has the potential to deliver much greater transparency of the operating businesses and allocation of capital, I would still point out that there are a number of structural issues that need to be considered and resolved, before any decision to put a NOHC structure proposal through a shareholder process can be made.

Ensuring the maintenance of the current credit rating position for each of the key operating entities in the Group in any NOHC structure, is by far the most critical factor in this investigation. But I am pleased to be able to say that preliminary advice from S&P indicates that the notional group operating rating could remain at 'A+/stable' and that the rating for both the Suncorp NOHC and Suncorp Metway Limited, the banking subsidiary, could remain at 'A/stable'. Now we'll get a further update on the feasibility of this process during the first quarter of the '09-10 year.

So if I close off by looking briefly at the existing structure of the Group, and we're onto slide 10. Suncorp Metway, the Bank, is obviously the current holding company for the Group. The Australian GI operations are conducted through Vero Insurance and Suncorp Metway Insurance Limited, and that includes the GIO business and a number of joint ventures.

Following the merger, Promina Group Limited and its related companies, sit underneath Suncorp Insurance Holdings Limited. Vero is one of those related companies and incorporates the various operating subsidiaries and joint ventures, which operate the major brand names such as AAMI and APIA. The Group's Wealth Management business, which includes life insurance, superannuation and funds management is conducted by SLSL, Tyndall and Asteron.

And a final slide, which is 11, shows the proposed Group following the second stage of the LER. The results will obviously be a much more logical structure, with all the General Insurance subsidiaries and Wealth Management subsidiaries aligned in separate groups. And I should say and stress again, that this work is well on track to be completed by the 1st of July 2009.

So that is all I wanted to cover in a formal sense, but we are happy for 10 or 15 minutes to take questions, so I'd like to hand back to the moderator to manage those.

Question: (James Coghill, Deutsche Bank) Just looking at this revised guidance for the full year and bad debt charge, so it can fly in that fourth quarter you are now expecting \$200 to \$300 million, so that's a doubling of what you saw in the third quarter, and that's annualised 140 to 220 basis points. So that really is a significant deterioration on what you saw in the third quarter, and all you flagged is valuation reviews that are going to be conducted. That seems a bit soon to justify that level of deterioration. So we've only got a month to go, I was just hoping that you could provide a bit more colour on why you think that deterioration is so severe in the final quarter?

Chris Skilton: James, it really is the valuation process. I think that valuations or property values have clearly declined. We've deliberately, I guess, put a lot of our valuations into June, because we want the most up to date position just prior to the cut off date. So generally I think in this sort of environment, that you are going to see greater charges coming through I'd say in the second and fourth quarters, rather than the first and third quarters. So it will be difficult and it would be wrong to extrapolate any one quarter into what might be a full year charge.

Now, we are being prudent in that range, let me say, but it really is a case of a preponderance of valuations that are going to come

	in and us being prudent. What we don't want to do is have a repeat of our November-February experience, where we thought things were running a lot more smoothly in November, and of course we got blown out of the water in the last two months of that period. So no, there is nothing more than the fact that it's a recognition that particularly commercial property prices are probably significantly under where they were six to 12 months ago.
Question:	(James Coghill, Deutsche Bank) The reference to SME deteriorating quite a lot in the first quarter, I presume that's continued into the second quarter?
Chris Skilton:	Yes, certainly. I mean, the credit cycle is definitely moving the way you think it is in the sense of the big corporates being hit first. We're now seeing a continued deterioration of SME, and that will be followed in our view broadly in six months by the consumer books. And I just stress that we're not going to have the same tail as the majors on the consumer books, because we don't have any of the major unsecured portfolios. But definitely I guess the recession is working out as you'd normally expect it to, with the pressure now moving on to the SME side.
Question:	(Chris Williams, UBS) I'm looking at slide 13 of the APS 330 disclosures and I'm looking in particular at the risk weighted balance against residential mortgages. So it looks like your total risk weighted assets have come down modestly, about $1 billion or 2.5% in the quarter. But the vast majority of that is actually in the residential mortgages. So my question really is that's pretty much core business – and the only risk weighted relief you appear to be getting is in core business rather than the non-core portfolio. So a couple of questions come from that. Can you just explain how you expect to see risk weighted asset trends move between core and non-core. Secondly, the level of undrawn commitments in the non-core book, particularly in development, finance and property

investment, and how they're being utilised at the moment; and whether there's any further risk weighted asset optimisation that you might be going through to try and manage that risk weighted asset balance.

Anthony Rose: The first question relates to the residential mortgage risk weighted asset classification. We have gone through a re-classification of the portfolio based upon the rules and the classifications into those buckets.

There were a number of loans that did have eligible residential security attached to them. However, there were aggregate facilities with multiple security types attached, where eligible residential security was previously reported in that bucket. We've gone through and recognised that that probably was not as accurate as it should otherwise be.

And it simply has been a reclassification in our reporting systems. Most of that has gone into a lot of the corporate lending. And you otherwise would have seen a drop off in that corporate book that is masked by that reclassification.

To go to the next question around commitment, the aggregate commitment balances, as they are reported here, actually factor in credit conversion factors; depending upon the duration and the type of facility, based upon APRA's rules and guidelines. In aggregate, in gross terms, the limits themselves have dropped by $400 million on the development finance portfolio.

Question: (Chris Williams, UBS) From what number? 400 down from where to where?

Anthony Rose: I've only got the credit conversion factors numbers in front of me, so I couldn't give you the gross number off the top of my head. The first drop by 400 – you won't see a 400 drop, or even a credit conversion factor. Those credit conversion factors range between 20% and 50%.

You won't see a 20% reduction in the factor because we've actually had an increase in some at 50%, and we've had a greater decrease in those that were at 20%. So there has been a bit of a shift in the portfolio as well in those facilities.

David Foster: I would just add to that, from an account management point of view, we have seen a number of paydowns and reductions across the corporate and some of the property portfolios. As we've flagged previously, we expect that to be a slow process.

But in parallel to that, we are still seeing some obvious drawing up of our pre-committed facilities in some areas. As Chris said, we think the non-core portfolio is now at a peak. But core to the individual account management is individual tactics and initiatives to reduce those non-core portfolios. And that, as well as the repricing activity, is tracking reasonably well.

Question: (Chris Williams, UBS) Regarding the LER process – obviously the first stage involved the diversification benefits in the Vero and Suncorp Insurance entities, with some consequent capital release. I'm just wondering if LER 2, or the NOHC investigation would actually envisage or lead to potential capital release from those entities.

Chris Skilton: No, generally we're not expecting any capital release, or indeed any extra capital required out of that restructure. It's much more to do with simplification of the group and transparency.

Question: (Chris Williams, UBS) And so the NOHC really leads to corporate flexibility in terms of the businesses which you own currently?

Chris Skilton: Correct.

Question: (Nigel Pittaway, Citigroup) Just a question on the core/non-core split. I just wondered if you could make some comments on how feasible it is in fact to split those from an entity point of view. So I guess where I'm driving to here is, is it possible to sell one off and keep the other, and what do you actually need to do in order to make that possible?

Chris Skilton: Well I'll answer it briefly and let someone else come in. They will remain in the same entity in the terms that both of those portfolios will sit in the bank. It's not inconceivable that if someone made an offer for either one or other or part of one – and I'm particularly thinking that if we had opportunities to sell down some of the non-core in a portfolio sense, we would certainly have a look at the economics of that. So it may not just be totally run-off.

But in terms of if someone made us an offer bluntly for the core portfolio, there would be a lot of issues around that. Particularly, we would have to establish with APRA how much capital we would have to hold against the non-core et cetera. So there would be a lot of issues that we would have to think through on that. So whether or not it would be possible, I can't say at this point in time. I think it will depend upon the circumstances, but you couldn't rule it out.

David Foster: The only couple of things I would add to that is – I mentioned the individual account plans, which are obviously looking at the run-off and exit opportunities at an individual level. We're also looking at that on a clustering of accounts as well as sub-portfolio levels.

The opportunities are quite different between the various parts of the non-core book. If you look at equipment finance versus the corporate book versus the property investment book, the opportunities and activities are quite different. But we are looking at that at a number of levels.

Question: (Nigel Pittaway, Citigroup) Okay, and I guess just a follow-up question to that with regard to the sort of comments that Graeme Samuel has been making at the ACCC, and certainly some rumours in the market that some of the majors have been warned off the purchase of the core book. Is there any comment you can make as to whether or not you think those are valid concerns or not?

Chris Skilton: Look, I will make a comment. And, you know, I think that clearly what is happening in the marketplace now is there's a big gap opening up between the AAs and the non-AAs. Because of the difference in the cost of funding, it's going to be very difficult for any non-AA to occupy the middle ground that Suncorp, Bank West, St George have done in the past.

They're going to have to rely much more on a greater level of deposit funding, where we're all paying the same rates. But we're not going to be able to be competitive, or anybody is not going to be able to be competitive, with the difference in cost of wholesale funding. So I'll make that point.

If Graeme Samuel thinks that the regional banks are going to keep the big bastards honest, then I think he's got to rethink it quite frankly. It's a bit like saying the corner grocery shop is going to keep Woolworths honest in terms of pricing power. I hear the comments, but I don't actually understand the logic or analysis that sits behind it. So that's all I can say.

Question: (Stuart Oldfield, Baillieu) Chris, I understand you might have communicated with staff last week on succession planning. Can you start there please?

Chris Skilton: Well I think on succession planning all I can say is that the CEO search is well underway. It's progressing as you would expect these things to progress. It's important to get the right answers, so the quality of the process is more important than the speed of the process. I think I'm probably allowed to say that we are at the shortlist stage. It is progressing normally and I will make no further comments there. The announcement will be made as appropriate.

Question: (Stuart Oldfield, Baillieu) I noticed you started running up liquidity. Do you see a day when that will peak out?

Chris Skilton: Yes, look, I think at the moment it's prudent to remain reasonably liquid, because although things are improving out there, they're still a little bit fragile. So I think prudence says you hold more than average levels of liquidity at the moment. And that's not just us; I think that's happening across the board.

Holding liquidity is expensive, and therefore it is a drag on margins. And at some point, I think when the markets begin to stabilise a little bit more, then the banking system as a whole will refocus on the appropriate level of liquidity. I guess the other thing I would say though is that the regulators may well have a say in this, because obviously the world, for many years, was focused on Basel II.

And it's interesting that Basel II said absolutely nothing about liquidity, and it's liquidity that caused the problems when particularly the short term offshore debt markets closed down briefly in September/October next year. So I would expect the regulators to have a revised view on appropriate levels of liquidity going forward as well.

Question: (Stuart Oldfield, Baillieu) Just finally, do you have any hopes that APRA might give you some relief on the capital charge you need to apply against your residential mortgages?

Chris Skilton: I don't expect to get any special treatment, no.

Question: (Ryan Fisher, Goldman Sachs) Just a quick question on funding. The $6.4 billion that has been done since 1 January – I'm just hoping you could confirm that none of that has been sold into the general insurance business. But also, probably more importantly, on the funding that was purchased by the insurance business a while back, could you perhaps comment on just a valuation trend in that, and also whether there's any plans to maybe divest any of that to improve the asset concentration issue?

Chris Skilton: Well firstly, I can confirm that none of the $6.4 billion has gone into the general insurer. Secondly, from a valuation viewpoint, I should say from a consolidated position, any valuation increment or decrement actually gets washed out on consolidation within the group. So that's not a major consideration.

In terms of concentration risk, let me say that we are quite happy in terms of the actual underlying instruments in terms of AAA rated domestic mortgages and of course you'd understand that there's a fair amount of subordinated cover that sits there. So the risk on these assets are probably as low as they can possibly be.

So the only concentration risk that some people can point at is operational risk. But quite frankly, as we're the manager of those, I'm very comfortable that at least we know what our operational standards are, whereas you don't know necessarily to the same degree what some other issuer may be.

Having said all of that, it is our intent over the next six months to wind back some of that exposure. But let me stress, we're not uncomfortable where it sits at the moment.

Question: (Ryan Fisher, Goldman Sachs) Thanks, Chris. Relating to that, clearly credit markets have been a bit kinder very recently, but has there been any change in the allocation of the general insurance tech reserves in sovereign versus credit?

Chris Skilton: No, we generally kept it pretty static. The spreads are moving about all over the place, as you'd understand, it's not just the spreads on the corporate debt but spreads on the semi-government's been moving around, so there's been a reasonable amount of volatility again and we don't quite know obviously where it's going to end up in five weeks' time. But the composition of the portfolio has remained pretty static.

Question: (TS Lim, Southern Cross Equities) Are you able to provide outlook forward the GI business and wealth management business?

Chris Skilton: No, we're not making any changes to our outlook at this point in time.

Question: (David Rosenbloom, Wallara) A couple of questions if I could. The first one around the whole NOHC thing. I mean I recall when Macquarie did it, it was kind of an expensive thing and I understand the structural stuff and the reporting and all that, but just carrying on, I guess from Chris Williams' question, is it safe to say that your analysis would show that if you did in fact want to sell the bank but you couldn't do it under your current structure, it would be just too prohibitive?

Chris Skilton: Oh no, look I'd say that anything is possible. Moving down the LER routes has certainly made the structures much cleaner if you wanted to separate, but there is no doubt devil in the detail. Macquarie actually paved the way in a lot of areas and even got legislation passed, so Macquarie have actually helped simplify the process. Also, we are as not as complex as Macquarie.

We've always wanted to move down the NOHC but the inhibiter has always been the credit rating. But having raised more capital and having revised the strategy which is a de-risking strategy, I think the rating agencies are more comfortable with the potential profile of the bank and that is really what has changed our view that it may be possible. And I just stress, may be possible.

So we don't think it will be costly to go down that route. I'm also conscious that we have a massive conglomerate discount in our share price, everybody on the line would understand, and I'm hoping that the greater transparency and simplicity of the group post this might help in unwinding some of that discount, through greater understanding of the group and particularly of the capital structures.

Question: (David Rosenbloom, Wallara) That's great and just secondly, you raised the point both in your presentation and in response to Graeme Samuel's comments about the competitive disadvantage that you and other regional banks are sitting at right now and it's hard to see that there's going to be an unwind of that in the foreseeable future. I'm just wondering how a bank competes in that kind of environment or do we see just a grind down in position over time?

Chris Skilton: Well I think what we're seeing now is - with the demise of the securitisation market and the widening of wholesale credit spreads, wholesale credit spreads will probably come back in, but they're going to come nowhere into where they were, nor should they because they weren't being appropriately priced for risk.

But really I think now with the size and pricing power of the majors, that non majors are going to have to go back to a balance sheet that is dominated by retail deposits and if you do that, then you have to invest in fairly low risk type assets. So my point being is, I think you're going to see a widening of the gap between the AA's in terms of being full service banks and those that are non AA's that will look more like large sophisticated building societies, for want of a better phrase.

So that middle ground whereby some of us were trying to position ourselves as small national banks, if you like, competing across the field and that was ourselves, St George and BankWest, is certainly going to be vacated. So I think that really means that the strategy that we're developing is absolutely the right one under the current circumstances, but I see it now very difficult for a small to medium sized bank to compete in those areas that are going to be largely funded with wholesale money. And I think that's going to be a challenge going into the future for governments in terms of policy, in terms of competition policy.

But my only comment is that if Graeme Samuel thinks at the moment that he wants to maintain the regionals because they're going to be a major competitor to the majors in those parts of the business, then I'm afraid I don't think he understands the dynamics of the market at the moment. As I said, my analogy is the grocery store on the corner being expected to keep Woolworths competitive. It's just not going to happen.

Question: (David Rosenbloom, Wallara) Sorry, just one last quick one from me. Do you see any policy or anything that would aid you in terms of the securitisation market?

Chris Skilton: No, I think securitisation market is essentially dead in terms of what it used to do, and what it used to do of course is allow you to recycle capital off balance sheet. But the change really came about two years ago with IFRS when securitised borrowings were bought on balance sheet and it's suddenly seen now as wholesale funding and no longer had the same impact on your capital base.

So I think the securitisation markets will be there and they will be a valid source of wholesale funding, but they'll just be one of many sources of wholesale funding, they won't have the same dynamics that allowed medium sized banks to basically grow their balance sheets as they did up to about two years ago.

Question: (Liam Walsh, *The Courier Mail*) Just going back onto that question with the NOHC though, doesn't any way that affect the Queensland legislation in terms of the head office? In other words, could it help you sell the bank at all?

Chris Skilton: No, it has no impact. I think all the legislation would still apply to the holding company.

Question: (Liam Walsh, *The Courier Mail*) Okay, fair enough. And just look just a second one, one of the slides, I think in slide 15, there was a big jump in the professional services in the impairments there, was there anything behind that at all?

David Foster: It may well be Babcock & Brown as an example, but there's nothing specific other than that.

Chris Skilton: Okay, well again thanks very much for your attendance at short space of time and we'll be looking forward to the full year's results and we'll be talking to you again at the end of August.

Thank you.

End of Transcript