CHAIRMAN'S LETTER
LINDSAY MAXSTED

A challenging year for financial services

This year has been particularly challenging for financial services entities, including for Westpac. The sector has been the subject of intense scrutiny and interrogation from Government, regulators, the media, and the community generally. Among various developments, legal actions have been filed by the Australian Securities and Investments Commission (ASIC); the Banking Executive Accountability Regime (BEAR), to be overseen by the Australian Prudential Regulatory Authority (APRA), was introduced; a review of competition in the sector was conducted by the Productivity Commission; and the Australian Competition and Consumer Commission (ACCC) established its Financial Services Unit.

However, far and away the greatest impact on public sentiment has been generated by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission). The Royal Commission, and its terms of reference, were announced by the Federal Government on 30 November 2017. I intend to devote a large part of this Chairman's letter to the Royal Commission for the following reasons:

- coverage of the Royal Commission has been extensive and many shareholders will have been shocked by some of the revelations;
- you may feel there is a disconnect between the vision and values of Westpac and the actual or alleged misconduct highlighted by the Royal Commission. In this regard you are owed an explanation to help bridge that disconnect; and
- it is important that shareholders understand how Westpac has responded, often in advance of the calling of the Royal Commission, or how we intend to respond to the important issues the Commission has raised.

First and foremost, Westpac and your Board take the process of the Royal Commission, and the evidence before it, very seriously. We have devoted significant time and resources to the process, including: providing material; supporting our witnesses so they can fully answer the questions posed; and in responding both to the Westpac-specific matters, and general policy questions posed by the Commission. We will of course continue to do so until the Royal Commission is complete.

The Royal Commission in context

The terms of reference of the Royal Commission are instructive. It is an Inquiry into *misconduct*; whether activity might have amounted to misconduct and whether any conduct, practices, behaviour or business activities may have fallen below community standards and expectations, as well as seeking to identify the causes and potential remedies. It is not an investigation into all aspects of financial services or indeed into conduct generally.

Investing in the future and helping customers remains our strength

Sharing returns

WHERE WESTPAC'S REVENUE[1] GOES

$22bn
2018 REVENUE

$6.4bn DIVIDENDS

$4.9bn STAFF EXPENSES

$4.7bn OTHER EXPENSES MOSTLY SUPPLIERS

$3.6bn 30.8% INCOME TAX RATE

$1.7bn RETAINED FOR GROWTH

$0.7bn IMPAIRMENT CHARGES

1. Revenue is net operating income and comprises net interest income and non-interest income on a cash earnings basis. This is before expenses, impairment charges and tax.

We are an organisation that has taken a "customer-first" philosophy seriously…

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

The Royal Commission, whilst obviously focusing on matters of extreme importance and interest for financial services companies and regulators, captures only a fraction of the activity taking place inside these institutions.

All four major banks had at various times leading up to the Royal Commission recognised that certain conduct did not meet legal or regulatory requirements, or had fallen short of community expectations. Building on this point, the Commissioner commenced his enquiry by asking entities to submit details of conduct over the previous ten years identified as misconduct or conduct that fell below community expectations. These submissions, together with other information gathered, have been subject to scrutiny and informed the themes identified by the Commission. For Westpac, much of this conduct is historical, has been reported to regulators and in many instances, been resolved or is being addressed. There are, of course, many areas where we need to do more to improve which I address below.

Putting these points in context, we need to be careful in generalising what the Royal Commission is finding and reporting. In particular noting that:

- whilst the Royal Commission is often reported as the "Bank" Royal Commission (and for many that reads the "four major banks") it is actually an inquiry into the financial services sector and all of the organisations that participate therein. While much effort has been directed to banking, a significant part of the Royal Commission's review has covered non-banking (as in non-lending) activities such as financial planning, superannuation and insurance, noting that Westpac participates in these activities through BT Financial Group. Indeed a number of case studies reviewed involved entities other than the four major banks.
- the degree of misconduct, or potential misconduct, exposed by the Royal Commission has varied across the banks and other financial institutions. Each of you, as shareholders, may draw your own conclusions on where Westpac sits in this spectrum. My point is simply that while there may be some common areas of misconduct, it is wrong to generalise this across individual institutions.
- there is a risk that this misconduct may inadvertently come to define the culture of the sector. Speaking for Westpac, I can categorically say that it does not define our culture (nor our governance and accountability which can be wrapped up with culture). Westpac's culture is defined by how our 39,000 people go about their daily business, which overwhelmingly, as set out in our vision statement, is to help our customers and communities to prosper and grow. It is challenging for the Royal Commission to form a view on overall culture when, by its terms, it is focused on *misconduct*.

As we consider culture it is clear that we, along with the broader industry, face a number of challenges. These include the need to rebuild trust and drive better customer outcomes. And programs are already underway to strengthen our culture and remove structures that may encourage poor behaviour. We are committed to continuing this work and meeting these challenges with honesty, integrity and transparency, and to being accountable to our stakeholders for our actions. We also regularly review and benchmark our corporate governance frameworks and practices. Your Board views good corporate governance as essential to achieving our goals, helping to underpin accountability and effective oversight, as well as providing a clear and consistent foundation for decision making.

Lessons for Westpac

Given the above context, my view on some of the important lessons for the Westpac Board and Group Executive team from the Royal Commission are set out below. Some of these points had been identified prior to the Royal Commission and hence actions to address shortcomings had commenced before this year. Those lessons are:

- **We did not sufficiently understand and analyse customer complaints and, in many cases, they were not dealt with promptly.** Westpac has over 12 million customers in Australia and the overwhelming majority have somewhere between a reasonable and positive experience with Westpac. We know this from numerous data points including customer surveys, Net Promoter Score (NPS) data, as well as directly talking to customers. However, we didn't focus enough time, resources or empathy on many of the customers we had let down.
- **We were slower to focus on certain non-financial risks such as conduct, compliance and reputation.** In the aftermath of the Global Financial Crisis, quite properly, there was significant focus on credit risk, liquidity risk and the overall strength of the balance sheet. We prioritised the largest potential financial risks and devoted insufficient attention to emerging conduct risk, compliance and reputation risks. This

relative lack of maturity of management of non-financial risks was compounded by a raft of ever-increasing, and at times overlapping, rules and regulations. This has sometimes been further complicated by changing regulatory expectations over time.

- **Some employee remuneration arrangements inadvertently contributed to poor behaviour.** While remuneration is not directly related to all of our conduct failures, in some cases our remuneration practices were poorly designed and the payment of commissions or the existence of other short term incentives linked to sales, may have resulted in poor behaviour.
- **We did not fully appreciate the underlying risks in the financial planning business.** Better training and supervision, changes to the way financial planners were remunerated, and/or better documentation of advice provided was required.

Needless to say, having identified the above points, your Board and management team have moved quickly to shore up the resources, systems and related reporting to deal with any shortcomings. Some of the improvements cannot happen overnight, particularly when technology systems need to change, but in these cases, our monitoring of the risks has been heightened and extra steps have been put in place. We are also accelerating customer remediation, recognising that where Westpac has made mistakes, we need to promptly take steps to fix these issues for customers. In his letter, Brian Hartzer also discusses what we are doing to address and learn from issues raised.

Again, recognising that the work of the Royal Commission still needs to be completed, for me at least, this intense scrutiny has also reinforced some very positive aspects of Westpac. There are five particular observations that support my earlier points of thinking about the Royal Commission in context both as to Westpac's conduct and culture generally and our relative position in the sector.

1. We are an organisation that has long taken a "customer first" philosophy very seriously – and this is enshrined in Westpac's vision. Actions to reinforce our vision and deal with some of the shortcomings identified have included:
   - Appointment of a Customer Advocate, Adrian Ahern. Joining in late 2016, Adrian and his team have established a new avenue for customers not satisfied with how a complaint has been handled. Reviews by the Advocate are completely independent and decisions are binding on the Group. Adrian and his team have made particular progress in resolving long-standing issues and in providing objective feedback on how we can better manage complaints. Adrian talks more about his role in a profile alongside my letter on page 10.
   - Appointment of a new Group Executive for Customer and Corporate Relations. Reporting to the CEO and with a direct line to your Board, this role is redefining how we manage, resolve and report customer complaints. The new division has brought together various teams with complaint handling responsibilities and is improving the complaints process for customers and identifying and addressing the root cause of problems.
   - We have established a new Vulnerable Customer Council – to better support customers who may be at risk, and to help them to avoid hardship and financial harm. The Council is supported by specialist teams with access to expertise in areas such as health and counselling to help manage customers often in complex circumstances. We have recently developed a customer vulnerability action plan and are actively looking at how we can respond to other socially important issues – like St.George becoming Australia's first dementia-friendly bank.
2. We are an organisation that values our employees and is a great place to work. Our people are our greatest asset and underpin our success. Reflecting our commitment, employee sentiment has remained high and stable this year at 73%[1]. Examples of our commitments to our people include:
   - Providing a comprehensive selection of personal development opportunities. In 2018 employees completed over 100,000 courses on our self-directed learning platform, LearningBank. Over 850 leaders graduated from the AGSM-accredited Certificate of Executive Leadership Program and 350 new leaders completed the Foundational Leadership Program. We also introduced a Young Leader Program to develop and support emerging leaders.
   - Providing opportunities for employees to get involved in their local communities and the causes that matter to them through a range of initiatives. Last year, employees shared over 29,000 hours volunteering their time and skills. In addition, over $6 million was collectively donated to registered charities through our matching gifts program.
   - Continuing to build on the diversity of our workforce. Last year Westpac reached the important milestone of – 50% Women in Leadership roles[2] and we've maintained that level – a culmination of various initiatives over many years.
3. We have always understood the need to be conscious of all stakeholders' needs if we are to provide satisfactory long-term returns for investors. We are not an organisation based on "greed" or on short-term profit. For example:
   - In 2015 Westpac commenced a comprehensive review of its products, reassessing items such as fees, terms and conditions and how products are sold. From this review we have taken action to reduce certain transaction fees, we've changed teller incentives and removed many products from sale. In this review we've prioritised good customer outcomes over financial gain.

1. An employee sentiment survey is conducted monthly. Six month rolling average stable at 73%.
2. Proportion of women (permanent and maximum term) in leadership roles across the Group, including the CEO, Group Executives, General Managers, senior leaders with significant influence on business outcomes (direct reports to General Managers and their direct reports), large (3+) team people leaders three levels below General Manager, and Bank and Assistant Bank Managers.

CASE STUDY
BETTER SUPPORTING CUSTOMERS

Our undaunted advocate for customers

Westpac's customer advocate, Adrian Ahern, is providing Westpac's retail, small business and wealth customers with an independent avenue for dispute resolution. Adrian's role complements the further changes Westpac has made during 2018, with the establishment of the Customer & Corporate Relations division.

In the past, customers who were not satisfied with the handling of complaints often avoided taking on the banks, worried about the cost, the likelihood of a fair hearing or the prospect of how they would fare noting the resources of a large company.

And so, in late 2016 as part of the Australian Banking Association's six point plan initiative, Westpac appointed Adrian Ahern as its Customer Advocate – shifting the balance in the management of complaints back to customers. Adrian has set up a team of 10 case managers, offering customers a second opportunity to have their complaint reviewed.

"We start with a clean slate and carry out a thorough review of every matter that comes to us. We listen to customers and encourage them to be open and frank. This helps us uncover all aspects of the matter and at times reveals a vulnerability or circumstance that should have been understood by the bank earlier," says Adrian.

Adrian has broad discretion to make decisions that are binding on the Group, but not on the customer. Over the last year, the team dealt with 450 cases. Of these, approximately one third of the Group's prior decisions were substituted; one third remain unchanged; and for the remaining third, the Customer Advocate agreed with the Group's decision but took further action to ensure a fair outcome was delivered. This was often because further information became available during the review process. In addition, Adrian provides feedback to help Westpac improve its policies and processes, including those relating to how it deals with complaints.

Adrian Ahern

Offering an independent view

Independence is fundamental to the role of Customer Advocate and while Adrian is employed by Westpac, his role is structured to support this.

"I don't report to any business unit, but rather to the Group Executive responsible for human resources. That said, I meet regularly with Westpac's CEO and Chairman, the agendas are always open and they usually start by asking me what I am seeing and how they can help," says Adrian.

"My remuneration is fixed and I'm not entitled to any short-term incentives. And most importantly, I have no hesitation in putting noses out of joint when putting things right for customers."

As part of his role as Customer Advocate, Adrian also acts as mediator between the Group and customers in a range of disputes across the Group, provides support to customers experiencing vulnerability and liaises with external stakeholders such as consumer and small business groups and the Ombudsmen to receive feedback on what Westpac can do better.

"Working with my team is the greatest aspect of my role. Each member brings a particular skill and perspective. And they have been through life experiences that help them approach matters with suitable robustness and also great empathy," says Adrian.

Against the background of the Royal Commission this year, customer complaints into Adrian's team have increased fourfold and range from issues involving responsible lending, elder and domestic financial abuse to incomplete wealth advice.

"Since the Royal Commission commenced, customer confidence in putting complaints to Westpac has increased, which is a very good thing because we get to fix what has gone wrong and put in place changes to ensure it doesn't happen again. At the same time, because of all that is happening in the external environment, we're seeing a lot of frustration directed towards the bank and that can be challenging."

Changing for the better

"Over the last two years I have seen a genuine openness and commitment to change within the bank" says Adrian.

"Westpac employees are passionate about customers and the Group is making changes that demonstrate a real shift in the way complaints are approached and managed. There's still work to do, but by listening more closely and understanding customers and their circumstances more fully, the Group is better placed to get it right in the first instance."

…Westpac is underway transforming the company using digital technology

- BT Financial Group has led the market in helping to transform the wealth industry for customers. Over recent years BT has increased education standards for its financial planners, changed planner remuneration and led the market in publishing feedback on planners from customers. This year the division removed grandfathered advice payments at a cost of around $28 million (post tax) per annum and materially reduced the cost to customers of using its wealth system Panorama.
- Similarly, as indicated earlier, our people are deeply committed to our vision and doing the right thing by customers. This is embedded in our values, and has been reinforced across the Group through additional training and updates to our code of conduct.
- Westpac has been consistently rated a sustainability leader by external governance bodies. This has included being a Leader in the Dow Jones Sustainability Index for much of the last decade. In 2018, Westpac ranked 17th. This year we also enhanced our disclosures on climate change and human rights, helping to maintain our leadership.

4. We have continued to lend prudently all through the recent period. Notwithstanding recognised issues with certain processes, which Brian Hartzer explains in more detail in his letter, our detailed work has confirmed that the credit quality of our mortgage portfolio remains sound, with Australian delinquencies remaining low and properties in possession lower than the same period last year. In addition, significant benefits have subsequently flowed to individual borrowers, and to the broader economy.

As a bank whose success is inextricably linked to the fortunes of Australia and New Zealand, we have no interest in lending to individuals and companies that cannot repay their loans. This has not changed over recent years and it is not something the Board would tolerate. Unfortunately recent market commentary continues to imply that banks are lax in their standards, lend irresponsibly and our processes are prone to systemic fraud. For Westpac, this is just not true.

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

While I could easily write my whole letter on this topic, shareholders need to only look to the outcomes of our lending for evidence. Today our credit quality metrics remain near cyclical lows across both businesses and consumers. In mortgages for example, less than 1% of our mortgage loans are more than 90 days in arrears, and for a portfolio with an exposure of more than $550 billion, the losses in 2018 were $86 million[3].

I will not repeat more statistics on this topic and urge shareholders to seek out the facts for themselves if they need any more comfort on our practices. We report an extraordinary amount of information on asset quality in our presentations, in our Annual Report and in our detailed Pillar 3 report – and it is readily available.

5. Our purposeful, consistent and large investment in technology is the way forward to further improve the customer and employee experience and hence shareholder value.

At the centre of this investment is the modernisation of our technology infrastructure. While it is often hard to visualise our progress, it is real and in 2018 we have had particular success in:

- Commissioning a new private cloud infrastructure for the storage and management of data. This major milestone significantly reduces our storage costs, enhances flexibility and slashes the time needed to create capacity for new initiatives;
- Continuing the development of Panorama, our funds administration system, rolling out new reporting functionality and enhancing the mobile app;
- Reaching major milestones on development of our Customer Service Hub, the Group's multiple brand operating system. The system is built around the customer and will help us materially improve service. The system will go live with new Westpac mortgages in 2019.

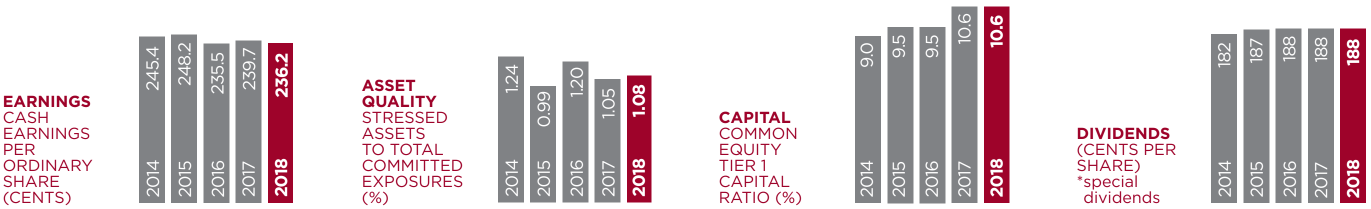
At the same time, Westpac is underway transforming the company using digital technology. This has involved automating manual activity and allowing customers to self-serve more of their routine banking. Amongst various changes this year we have introduced a new online mortgage application in St.George, voice banking for Apple devices, and created the ability to cancel a credit card online. Our online services have also expanded, including allowing customers to access historical statements from closed accounts.

One change over the year that many shareholders may appreciate is the ability to deposit a cheque using the Westpac mobile app on their phone – an Australian first. This new feature

3. Actual mortgage losses net of insurance.

Performance Metrics

CASH EARNINGS BASIS



eliminates a major reason why people go to a branch and allows customers to take an image of a cheque and deposit it directly into their account – at any time of the day. It's just another way we are making banking easier.

2018 financial performance

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

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

On the balance sheet, the story is a strong one. Our common equity tier 1 capital after deductions increased by 6% over the year and we have maintained our common equity tier 1 capital ratio at 10.6% – above APRA's unquestionably strong benchmark. Westpac's liquidity position is similarly strong with $154 billion in liquid assets providing the Group with significant funding flexibility. Our two key liquidity ratios, the Liquidity Coverage Ratio and Net Stable Funding Ratio, were both comfortably ahead of regulatory benchmarks.

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

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

Dividends

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

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

The Dividends for the full year represent a payout ratio of 80% which is slightly above our longer term target of 70%-75%. The 94 cents final dividend represents a dividend yield of 6.7% based on the closing share price at 29 September 2018 of $27.93, or a yield of over 9.5% after adjusting for franking.

The final ordinary dividend will be paid on 20 December 2018 with the record date of 14 November 2018.

Remuneration outcomes

In the Board's assessment of Westpac's performance, earnings were below expectations while the balance sheet was stronger across capital, liquidity and credit quality. The Group made good strategic progress with its service strategy and has continued to build the quality and diversity of its workforce.

In aggregate, the Group's balanced scorecard outcome was below target. Further, to reflect executive accountability for risk and reputation matters (related to the Royal Commission in the context I have outlined above), the Board has applied discretion to further reduce short term variable reward outcomes.

As a result, short term variable reward outcomes for the CEO and Group Executives in Australia are on average 25% lower than 2017 levels. At the same time, the performance hurdles for the 2015 Long Term Variable Reward (LTVR) plan were not met and, as a result, the awards were forfeited in full for the third consecutive year. Forfeiting of long term variable reward is consistent with the relatively weak performance of shares in the banking sector, including Westpac, over the last few years, including the 2018 financial year.

Given the significant reduction in short term variable reward, and no vesting under the long term variable reward, the Board feels that 2018 remuneration adequately reflects both performance (on all fronts including financial, customer and risk management) as well as shareholder outcomes.

We will learn from the Royal Commission but we are not defined by it

Board changes

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

Over the year we appointed two new directors on the Board with Peter Nash starting in March 2018 and Anita Fung joining the board in October 2018. We also announced that Peter Hawkins would retire post Westpac's 2018 AGM.

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

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

Peter Hawkins first joined the Board in the volatile times of 2008, and with his deep banking experience helped steer this company through a decade of significant change. Personally, Peter has been a great support to me and an excellent shareholder advocate and I wish him all the best in his future endeavours.

While leaving the Board, we will continue to benefit from Peter's expertise as a member of the Bank of Melbourne Advisory Board.

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

My commitment

Reverting to the main theme of this year's letter there are two final, very important, points to raise. Your Board is here to represent shareholders and we shall unashamedly continue to do so including striving to provide you with the best possible returns on your equity over the long term. We understand that for a well-run bank (or any commercial organisation) this will not, and cannot be, at the expense of the customer. The most successful organisations treat their customers and employees well and from there the financial returns flow.

The final paragraph in my Chairman's letter to you last year concluded:

> *"One of the key things our 200th anniversary (April 2017) has shown me is the passion and commitment of the people of Westpac to supporting our customers and creating a better future for all Australians and New Zealanders. It is this passion and commitment that has seen us through the highs and lows of the past 200 years and continues to drive us forward and helps us continue to deliver sustainable returns for you, our shareholders."*

I believed that statement then and I believe it now. I hope that, if as a result of the Royal Commission or otherwise, you were beginning to question what Westpac stands for, and what drives us as an organisation, this commentary provides you with answers and context. We will learn from the Royal Commission but we are not defined by it.

LINDSAY MAXSTED
Chairman
Westpac Group