

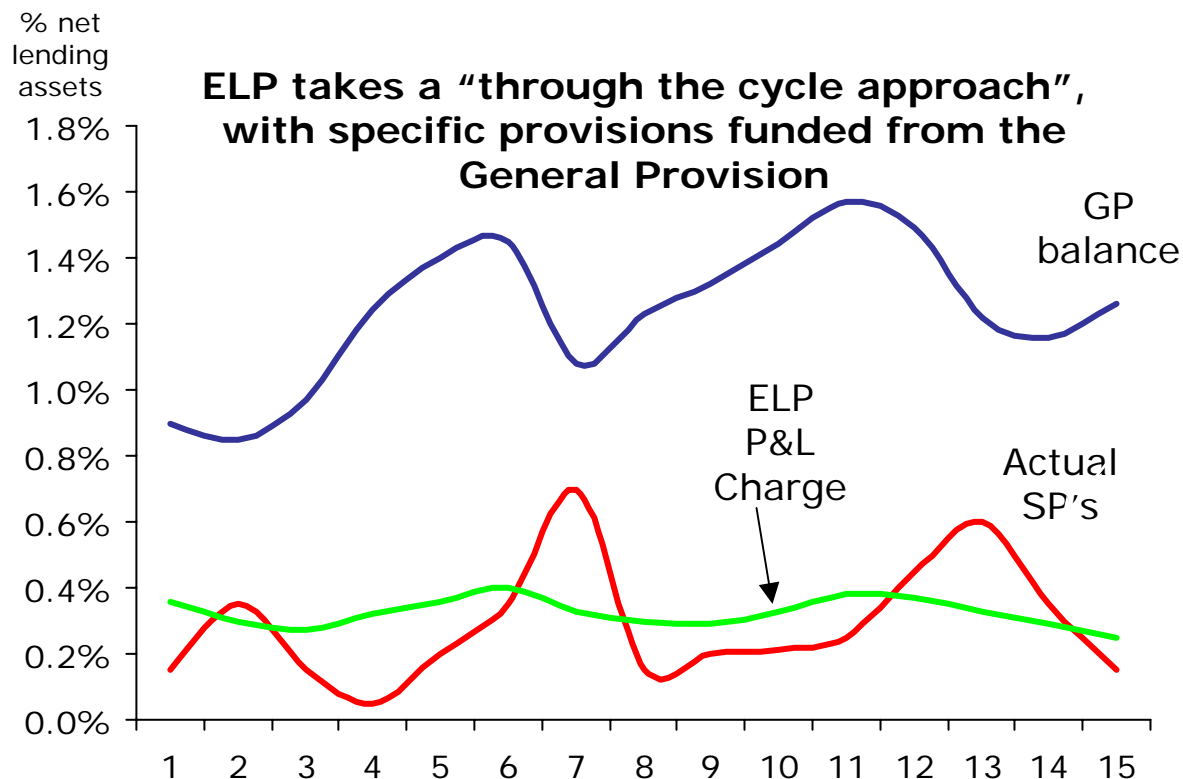
*Transition to AIFRS*  
*Credit Provisioning*

Australia and New Zealand Banking Group Limited

# Moving from Economic Loss Provisioning (ELP) to IFRS provisioning

- The two methodologies are significantly different
- ELP charge relatively stable compared to total IFRS provision charge
- Increased earnings volatility anticipated under IFRS driven by provisioning charge
- ELP required to be disclosed under Basel II, and ELP still used in EVA calculations and internal pricing models

# Credit provisioning under ELP



**ELP Charge**  
 = Exposure at Default  $\times$   
 Probability of Default  $\times$   
 Loss Given default

**Plus**

An adjustment to ensure the GP balance is sufficient to cover:

- Volatility around expected loss (using statistically quantified variance)
- Remaining term of loan portfolio
- Balance sheet growth

ELP charge will vary over the cycle based on:

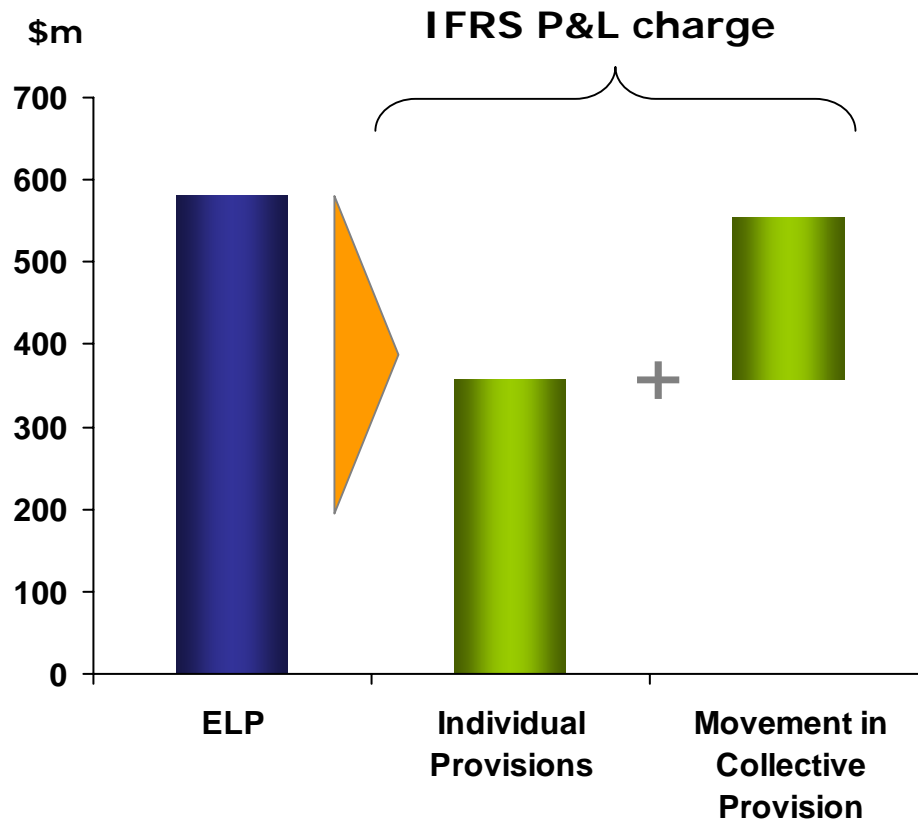
- changes in lending volumes
- change in risk grade profile
- security levels
- product and geographic mix

- Exposure at Default – The total exposure the Bank has to the customer at the time of default. The time of default is assumed to be in 1 year. This figure includes all outstandings, unexpected usage of unutilised limits that may be drawn at default, and all fees and charges.
- Probability of Default – The probability of a customer defaulting on their loan. This figure is inclusive of the credit quality of the country in which the customer is domiciled.
- Loss Given Default – The total charge to profit to be incurred at the time of default. These charges include principal, administration, legal fees and the cost of foregone income due to the default.

# Credit Provisioning under IFRS

## Significant changes to credit loss provisioning methodology

Based on 2005

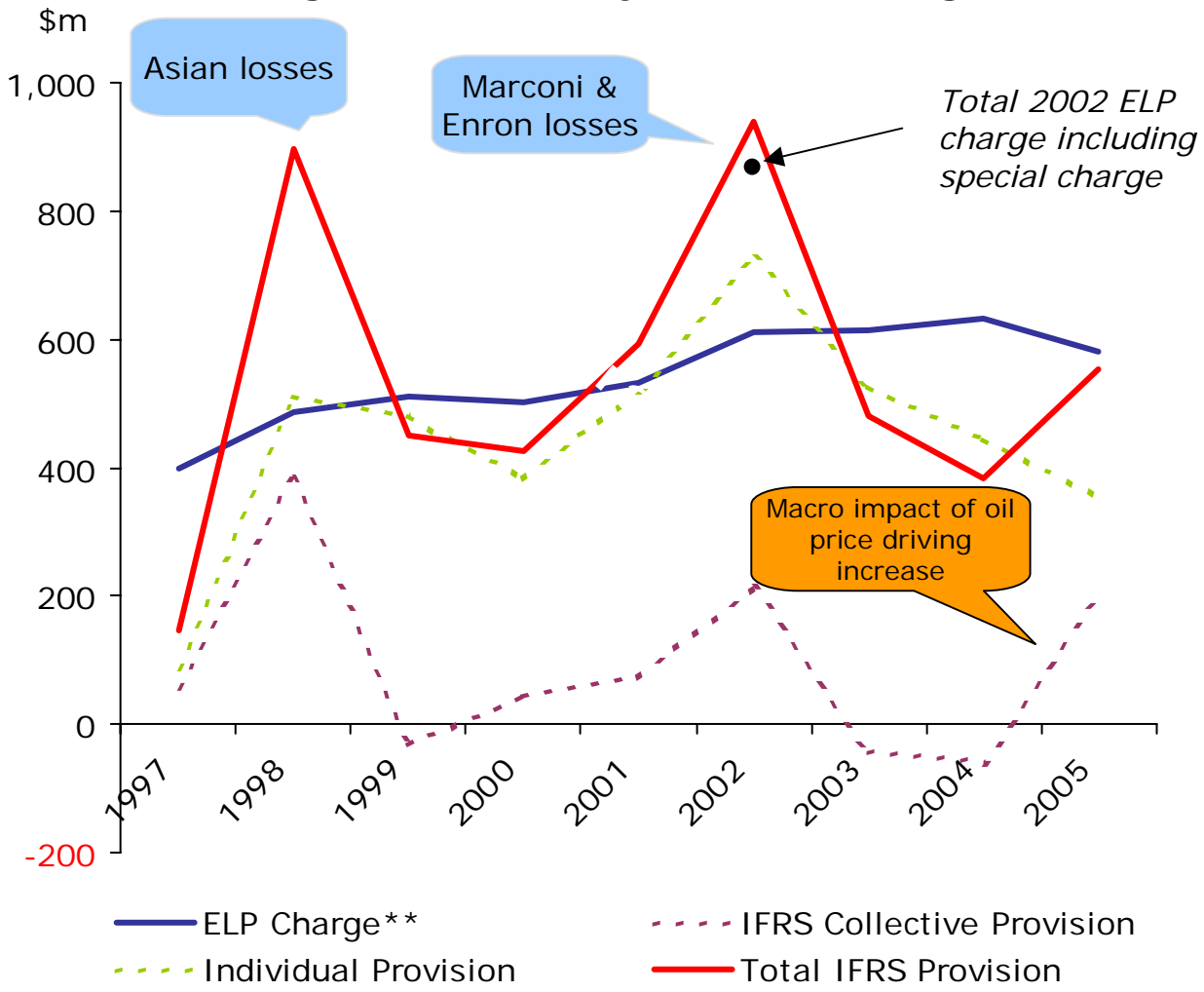


- ELP will be replaced by a charge for:
  - Movements in Individual Provisions (IP),
  - Plus/minus a charge for movements in the Collective Provisions
- IP's determined individually for large loans and on portfolio basis for 'retail' loans
- IP's reflect the loan carrying amount less PV of expected future cash flows.
- All loans not specifically provided for are collectively assessed
- Collective Provision replaces current general provision
- Collective Provision function of change in:
  - Portfolio size
  - Portfolio mix
  - Risk & cycle outlook

# Increased earnings volatility anticipated under IFRS driven by provisioning charge

- ELP charge relatively stable compared to total IFRS provision charge
- Collective provision function of
  - Probability of Default & Loss Given Default
  - Portfolio concentration
  - Specific events
  - Risk & Cycle conditions

IFRS Provision charge exhibits greater volatility than ELP charge



\*\*excludes special GP charge in 2002



# Provisioning post IFRS

IFRS Component	Current Equivalent	Balance Sheet Provision	Profit and Loss Impact
Individual provisions	Specific Provision	1	$\Delta 1$ = New provisions ( <i>including those provided for and written off in the same period</i> ) <b>add</b> increases in existing provisions <b>less</b> write-backs & recoveries
Collective Provisions - long-term historic performance - economic cycle adjustment - model risk and scenario modelling adjustments	} ELP less specific provisions	2	$\Delta 2$ = Current Period Collective Provision <b>less</b> Prior Period Collective Provision
<b>TOTAL</b>		<b>1+2</b>	<b><math>\Delta 1 + \Delta 2</math></b>

# Comparison to ELP

	ELP	IFRS
<b>Losses included</b>	<ul style="list-style-type: none"> <li>Average one year loss expected to be incurred if the same loan portfolio was held over an economic cycle</li> </ul>	<ul style="list-style-type: none"> <li>Losses inherent within the Group's existing loan portfolio including:                             <ul style="list-style-type: none"> <li>specifically identified losses on individually significant loans and on a portfolio basis</li> <li>presently unidentified impaired loans, provision collectively assessed</li> </ul> </li> <li>Collectively assessed losses are based on long term historic portfolio performance adjusted to account for:                             <ul style="list-style-type: none"> <li>current market conditions</li> <li>model risk &amp; scenario modelling</li> </ul> </li> </ul>
<b>Discount Rate</b>	<ul style="list-style-type: none"> <li>Internal funding rate</li> </ul>	<ul style="list-style-type: none"> <li>Original Effective Interest Rate (OEIR)</li> </ul>
<b>Credit provision on undrawn commitments</b>	<ul style="list-style-type: none"> <li>Includes average one year loss on expected drawdowns if the same portfolio was held over an economic cycle</li> </ul>	<ul style="list-style-type: none"> <li>Includes loss on expected drawdowns over the remaining life of the facility</li> </ul>

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