Presentation at UBS Australian Financial Services Conference by Michael Cameron

Title Slide: UBS Australian Financial Services Conference

No text

Slide 2: Disclaimer

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Slide 3: Speaker's Notes

- Speaker's notes for this presentation are attached below each slide.
- To access them, you may need to save the slides in PowerPoint and view/print in "notes view."

Slide 4: Agenda

- Good afternoon. I hope you have enjoyed the last day and a half. It's my pleasure to talk to you about Commonwealth Bank whilst you enjoy your lunch.

- In keeping with the theme of the conference, my presentation today will cover:
    - The trends we believe are shaping the long term growth outlook for financial services
    - The Bank's current positioning, key competitive strengths and how we are organising the Group to respond to this outlook and finally;
    - Examples of how our divisions are positioning themselves to deliver growth both in the short and longer term.

Slide 5: Long Term Growth Outlook

Let's start with the long term growth outlook.

Slide 6: Strong credit growth over the last 20 years…

- Post-war credit growth in Australia (as a percentage of nominal GDP) has increased steadily, with growth accelerating to an average 12% p.a. over the past 20 years.

- The current growth in total credit is above the 20 year average and has been led by a strong housing market, as a result of:
    - continued low interest rates
    - tax benefits of investing in your own home or investment property, and;
    - the relative attractiveness of housing compared with other investment classes.

- We expect credit growth to slow over the next couple of years down to around 7-10% primarily driven by housing which is expected to halve from the current rate.

Slide 7: … but banking margins have been squeezed

- This slower credit growth is likely to occur in an environment where margins are going to be falling.
- Looking at the trend over the past decade, operating margins in banking have fallen consistently and this is expected to continue.
- Competitive advantages in scale, a large customer base and extensive distribution will become increasingly important in managing this ongoing trend.

- Clearly, efficiency will be a major factor.

Notes to Chart:
- Total Controllable Assets refers to balance sheet assets + Funds under management and administration (excl. custody assets under administration)

Slide 8: Investor returns – natural cycle or structural shift?

- Weaker equity markets over the past 18 months or so have seen the expectation premium assigned by investors fall and company valuations shift back to fundamental values.
- With interest rates already at historically low levels, another structural rise in the PE ratio is unlikely and inflation is not expected to support EPS growth.
- On this basis, most forecasts are for equity markets to continue to produce single digit returns (capital growth plus dividends) over the medium term.

Slide 9: Weak equity markets and declining fund flows

- Looking at recent equity market trends, we can see the extent to which markets have weakened.
- The All Ords has shown more resilience than other equity markets, and there is no evidence to suggest that this won't continue.
- In the context of the funds management industry, the impact of weaker equity markets has been significant, particularly for the retail market, which has experienced lower fund flows.
- There will need to be a sustained recovery in equity markets before we are likely to see a return to the inflows of a few years ago.
- A longer term consequence of the difficult period currently being experienced will be downward pressure on fees and margins. This means that those players with scale and a large proprietary distribution network are better placed to outperform.

Slide 10: Recent trends shaping the future of funds management…

- Notwithstanding the current environment, there are a number of longer term trends shaping the funds management industry:
  - The industry is expected to grow at a rate of approximately 8% pa over the next decade.
  - The retail market is projected to grow at more than double the rate of the wholesale market (11% compared to 5%), mainly from demand created by compulsory superannuation.
  - Some segments are projected to grow faster than others. The graph on the left hand side of the slide shows those segments of most relevance to CBA.
- The rapid growth in wrap style products and master trusts is significant with almost 70% of all retail gross flows now going into master trusts.
- There has been significant consolidation of the main players in the Australian market. Australia's four major banks and fund manager AMP together manage almost 60% of the retail funds management market and 30% of financial advisers.
- Advisers are increasingly being owned by institutions - 17 of the top 20. This distribution dynamic increases the relative importance of internal distribution - highlighting it as a key competitive advantage.
- As the industry matures, the importance of the distribution component of the value chain is expected to increase. Changing dynamics will make it increasingly important to compete in all parts of the value chain, and provide:
  - reduced exposure to pricing pressure in any one segment
  - greater flexibility in using pricing as a tool for competitive positioning;
  - and provide unique positioning to package a broad product offering to customers
- The main bank players in wealth management are well placed to leverage technology and deliver 'scalable advice'. This is important because of increased competition, expected single digit investment returns and the growing profile of index management.

Slide 11: …and the life insurance industry

- As with funds management, there are a number of trends also shaping the outlook for the life insurance industry:
  - Industry growth over the past 10 years has been strong at around 15% p.a.

    - As I have mentioned, equity market weakness has impacted recent profitability by reducing investment returns. Looking forward, investment returns are expected to be more subdued than those experienced over the last few years.
    - Based on current projections, industry growth is expected to continue at around 10% p.a. over the next decade.
- Repricing of products is under-way across the market to restore profitability.
- As a result of industry consolidation over past years, there still exist a number of overlapping and duplicated product sets, which are being maintained on a range of legacy systems. The opportunity is to continue eliminating some of the old style products, migrate customers to equivalent products, and progressively shut down the legacy systems.
- The industry is facing an environment of increasing regulation, particularly through FSRA. These changes include increased fee transparency and stricter training for agents.
- A key impact of FSRA is the expected attrition of life agents due to increased training requirements combined with an ageing of the agent workforce. This will intensify competition to attract and retain quality life agents.

Slide 12: Summary

So, in wrapping up the long term growth outlook, we think credit growth will slow and margins will continue to decline, whilst funds management and life insurance businesses will continue to grow strongly.

Slide 13: Commonwealth Bank's Position

Let's now move onto the Bank's position.

Slide 14: Organising to meet current and longer term challenges

- It's simple, we are committed to productivity improvement.
- We will concentrate on removing activities to simplify our processes and systems. We will improve the customer experience, and reduce our costs going forward.
- These initiatives will provide:
    - Improved turn-around times, reliability, accuracy and output quality
    - Together with simplified front-end processes and interactions that directly involve customers
    - And finally, better tools to equip staff to deliver integrated, quality service
- We remain committed to deliver an average of 3-6% p.a. improvement in underlying bank cost to income ratios over our plan period.
- Looking at the longer term, it is important that the work we do now positions us for strong growth.

Slide 15: Our starting position

- We have a wonderful starting position to meet the longer term challenges.
- With leading market shares in over half of our portfolio and a very diversified business mix. This means we can better manage the changes in demand across the portfolio.
- Successfully meeting the needs of our customers through a broad range of banking and wealth management services is the key to retaining customers and growing revenue.

Notes to chart:
- Corporate and business lending excludes lending to institutional segment in IBS
- Institutional Banking Products includes project finance, structured finance and institutional lending
- Merchant acquiring, asset finance, corporate & business lending and transaction services are provided by IBS Working Capital Services

Slide 16: A re-aligned organisational structure

- The alignment of divisions along customer lines gives us a clear line of sight between our customer needs and our lines of business.
- It enables the Bank to leverage customer relationship opportunities and to minimise process duplication.
- Our divisional strategies incorporate a review of the relative performance and growth of every

line of business, with the interaction between lines of business and customer groups clearly understood.

Slide 17: Deepening our customer relationships

- Part of our strategic focus is now to deepen our customer relationships by moving from a pure cross sell approach to a more needs based bundling of services.
- The by-product of this is an increase in customer retention.
- Work is being undertaken to:
  - determine a concise definition and consistent measurement of customer relationships
  - ensure a standard application of sales and service systems across the whole Bank; and
  - And finally, establish clear customer relationship targets.
- Around 40% of adult Australians have a relationship with the Commonwealth Bank, and 30% of adult Australians consider us their primary bank. For many people, their relationship with the Commonwealth Bank begins at primary school. I'm sure there are a number of you in this room that used to 'Get with the strength'.

Slide 18: Summary

So, to wrap up the Bank's positioning, it's about productivity improvement and more importantly, it's about the customer.

Slide 19: Divisional Focus

I'll now highlight some examples of how the Bank's five customer facing divisions are positioning themselves to perform strongly over the long term.

I'll start with Retail Banking Services.

Slide 20: Retail: a leading profile

- Together with core strengths such as our brand and leading market share position, our distribution strength is an area of real competitive advantage.
- We have the largest and most extensive distribution network in Australia.
- This provides tremendous opportunities for sales and service, and for operating as a scale business to drive processing and cost efficiencies.
- This is being realised by focusing on:
  - streamlining products and redesigning processes
  - increasing front-line staff delegations, and
  - improving our systems and network infrastructure.

Slide 21: Retail: product positioning

- We have positioned our core retail products to deliver greater value over the long term:
- <u>Transaction products:</u> Product and fee structures have been simplified to provide a sustainable platform for the delivery of transactional banking services to our customers.
- <u>Home loans:</u> We are redefining the home loan process to achieve improved service quality at lower cost. This involves streamlining application and establishment processes, and focusing on improving the servicing and retention of customers.
- <u>Credit cards:</u> We have grown our market share in a competitive environment by focusing on greater product bundling and product innovation.
- <u>Deposit products:</u> We have focused on improving our existing range of products. We are using the size and spread of our customer base and distribution network to our advantage in maintaining our leading market position. Retail deposits make up around 65% of the Bank's total funding requirements and this is a significant benefit from a funding cost perspective.

Slide 22: Premium: a differentiated business model

- For the premium segment, the Bank's opportunity is around growing the potential that already exists in the customer base, by delivering a differentiated business model:
- This is being done in two ways:
  - First, by creating a high value service experience. Our service approach is team based.

Each client is provided with a primary relationship manager, supported by a number of experts that provide secondary relationship management and a range of specialist advice.
    - Second, by developing a differentiated product set that is unlike other products available from within the Bank or the wider market. To deliver this, we have integrated our banking and broking platforms. This gives premium customers access to an extensive range of products that we have packaged into unique offerings. These products are sourced from all divisions across the Bank, and where necessary, externally.
- We are also in the process of rolling out our unique relationship management platform - Republic, which will underpin the delivery of our premium business model to our customers.

Slide 23: Premium: building a long term business

- We are building a long term business, which is tracking well to date.
- By the end of June 2003, we will have migrated more than 170,000 relationships.
- At this point, we have almost all of our physical infrastructure in place, with most of the staff we need and most of our systems completed.
- We also recently acquired the Australian retail brokerage operations of TD Waterhouse for a number of reasons:
    - the complimentary customer base of around 300,000 accounts
    - the natural fit of the TD Waterhouse business and staff with CommSec, and
    - the significant scope for cost synergies.

Slide 24: Institutional & Business: redesign for business customers

- In the Institutional and Business Services division, the Redesign Programme has been the critical change initiative over the last year. We have focused on the streamlining of processes and improvement in service levels. The Programme has also achieved:
    - the segmentation of our client base into 3 broad client groups - institutional, corporate and business, and
    - a clear understanding of the different value drivers in the Business and Corporate Banking client base.
- A key outcome of the redesign work relates to the Business segment of our customer base. For these customers we have identified that we have a cost ratio that must be reduced.
- For example, small business customers have a 74% cost to income ratio. So there are efficiency gains to be made, and there is scope to divert more resources to higher value relationships.
- We are addressing high cost ratios through the streamlining of sales and service processes and the introduction of a centralised service model.
- When fully implemented, the process and service model changes will better position the Bank to deliver more responsive service at lower cost.

Slide 25:Institutional & Business: improve overall satisfaction levels

- The improvements to processes and service undertaken during the IBS Redesign Programme will be built on going forward with the development of a differentiated and effective sales and service culture.
- To measure the success of the work being undertaken, customer satisfaction levels will be a key indicator.
- Using our Business customer segment as an example, this is currently showing a satisfaction level of around 53%. Clearly more work needs to be done in this area, and this is an immediate focus for us going forward.

Slide 26: Funds management: building opportunities

- Moving on to the Funds Management Business.
- The Bank has a number of areas of strategic focus to further build on its industry positioning and differentiate its wealth management business:
- Let me Start with:
- <u>FirstChoice:</u> The Bank's master trust offering continues to grow strongly, with over $2.8bn in funds under administration at 31 May 2003 and inflows of $60m per week.
- <u>Integration:</u> Considerable integration work has been undertaken to merge our investment management businesses under the CFS name, whilst retaining dual investment styles. Going forward, rationalising legacy systems will provide opportunities for further efficiency

improvements.
- Style diversification: The Bank offers wide investor choice by offering increased style diversification through the combination of the growth style CFS funds, style neutral CIM funds, the various offerings available through FirstChoice and the value offering through 452 Capital.
- Leverage internal distribution: Given the trend towards institutions owning distribution channels, we see optimisation of internal distribution channels as very important. Our focus is to build on the relationships with all our internal distribution channels - the customer facing divisions of the Bank, Financial Wisdom, Commonwealth Financial Solutions, and CommSec.
- Leverage scale: Given that a significant proportion of the costs of this business are volume driven, the Bank is focused on leveraging scale to achieve ongoing unit cost containment.
- Alternate Assets: Some further examples of innovation include adding alternate asset classes, such as private equity, hedge funds and infrastructure investments.
- International: First State UK is recognised as a manager of global equities, global bonds and various regional portfolios. First State also has operations in Hong Kong and Singapore from which we manage retail and institutional funds.

Slide 27: Insurance: distribution, service and risk pricing

- In relation to the insurance business, we see several opportunities for gains. We will do this through the improved leveraging of scale and distribution, improved pricing for risk and claims management, and through increased process efficiency.
- Whilst we are number one in insurance sales in Australia, that success has come with very few sales through our proprietary distribution channels. Our focus is to build the volume of sales through the branch network.
- We are doing this through the introduction of personal insurance consultants (PIC's) and business investment managers (BIM's) to the network. To date, we have grown this combined sales force to approximately 150. This has seen increased demand and increased referrals from relationship managers, and the internal home loan and mortgage broker channels.
- Significant efforts have also been put into the repricing of premiums to better reflect changes in underlying risk and competitors pricing.
- Customer service and product sales have also been improved through the upskilling of call centre staff to assist with insurance inquiries and we continue to develop our sales forces.
- Areas of ongoing focus also include product rationalisation and migration to modern systems architecture.

Slide 28: International: our geographical presence

- Our International presence spans banking, life insurance and funds management, with businesses or points of representation in New Zealand, US, UK and Asia.
- We continually review our international businesses to ensure that they will generate appropriate long term value for our shareholders.
- These reviews have in the last two years led to the divestment of businesses in Thailand, Malaysia and the Philippines. These businesses did not meet our portfolio criteria.
- In terms of our Asian life operations, in addition to our Hong Kong business, we believe that other Asian markets offer significant growth potential going forward, they utilise very little capital, and are not a major management distraction. We see these markets as long term option plays.

Slide 29: International: ASB Bank a strong performer

- In New Zealand, our ASB Bank subsidiary has performed strongly and is an example of how the Bank's international businesses are adding long term shareholder value.
- Whilst ASB is the fifth largest bank in New Zealand, it has the fastest growing market share and is consistently rated first in customer satisfaction and product innovation surveys.
- ASB has over the past 10 years achieved significant compound annual growth in terms of profitability, which has been achieved through:
    - Strong and increasing market shares in all major businesses.
    - Eliminating duplicated processes and developing middle and back office centres of excellence, and
    - Expanding product distribution through proprietary and third party channels.

Slide 30: Summary

- Let me summarise the key points for the divisions:

- Across our Banking business, we are undertaking a range of initiatives to improve the service experience of our customers, with success already being achieved.
- We are building on our leading funds management position through our diverse product and distribution platforms, the benefits of integration, and innovation.
- Our insurance business is well positioned to benefit from industry growth, with a great opportunity to increase sales through the branch network.
- Internationally, we continue to develop our businesses, with North Asia being an area of focus over the long term.

Slide 31: Key Points

So in closing:
Credit growth will slow, and margins will be squeezed.
Funds management and life insurance will continue to grow.
Our focus is on improved productivity and commitment to our customers.
In our divisions, the focus is on undertaking a range of productivity and service initiatives and building on the opportunities within each business.
The outlook for Australia is positive, the financial services sector is well positioned, and I'll leave it to you to decide 'Which Bank'.
Thank you, and I would now like to take your questions.

Title Slide

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