

SUPPLEMENTARY EXPERT WITNESS REPORT

**In relation to ANZ's Authorisation Application
For proposed acquisition of Suncorp Bank**

Dr. Jeffrey Carmichael AO
13 May 2023

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Acknowledgement

I acknowledge that I have read the Harmonised Expert Witness Code of Conduct and that I agree to be bound by it.

I confirm that the contents of my Supplementary Report dated 5 April 2023 (**Supplementary Report**) conform with the requirements of the Code and that my opinions are based wholly on the specialised knowledge acquired through my training, study, and experience.

My Qualifications as an Expert Witness

My qualifications are outlined on page 1 of my Expert Report dated 25 November 2022 (**Original Report**).

Assumptions and material facts relevant to the supplementary opinions expressed in this Supplementary Report

See:

Attachment 1: Supplementary Letter of Instructions from Ashurst Australia dated 30 March 2023.

Attachment 2: Supplementary Letter of Instructions from Ashurst Australia dated 16 April 2023.

Attachment 3: Supplementary Letter of Instructions from Ashurst Australia dated 27 April 2023.

In addition to these Supplementary Letters of Instructions, I was provided with copies of:

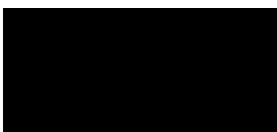
- Bendigo and Adelaide Submission to the ACCC (**BEN Submission**).
- Expert Report by Stephen King (**King Report**) submitted to accompany the BEN Submission.
- ACCC Statement of Preliminary Views (**SOPV**).

Other matters required by the Harmonised Expert Witness Code of Conduct

Covered in the Supplementary Report below.

Declaration

I have made all inquiries that I believe are desirable and appropriate for addressing the questions posed. It is my opinion that no matters of significance relevant to these questions have been withheld from this Supplementary Report.



Jeffrey Carmichael

13 May 2023

SUPPLEMENTARY EXPERT WITNESS REPORT
In relation to ANZ's Authorisation Application
for Proposed Transaction to acquire Suncorp Bank

1. Background

1.1 I have received three additional instructions in relation to ANZ's Authorisation Application for its Proposed Transaction to acquire Suncorp Bank.

- (a) The Supplementary Letter of Instructions for this engagement (**First Supplementary LOI**), dated 30 March 2023 (see Attachment 1 to this Report) instructs me to review the submission made by Bendigo and Adelaide Bank (**BEN**) to the ACCC (**BEN Submission**) made in response to the ACCC's public consultation process in relation to the Authorisation Application for the proposed acquisition (**Proposed Transaction**) of Suncorp Bank by ANZ Bank (**ANZ**).

The First Supplementary LOI requests that I prepare a supplementary expert report addressing the following questions:

Further to the questions set out in our letter of instructions of 9 November 2022, you are instructed to prepare a further written report, which:

- (a) *addresses the matters raised in the BEN Submission in so far as they relate to the questions asked of you in our letter of instructions of 9 November 2022, and the opinions set out in your Original Report; and*
- (b) *identifies any changes in the opinions expressed in your Original Report and, to the extent required, the reasons for such changes.*
- (b) The second Supplementary Letter of Instructions for this engagement (**Second Supplementary LOI**), dated 16 April 2023 (see Attachment 2 to this Report) instructs me as follows:

Further to the questions set out in our letter of instructions of 9 November 2022 and the instructions in our letter dated 30 March 2023, as part of preparing the Supplementary Report, you are instructed to:

- a) *address the matters raised in the SOPV in so far as they relate to the questions asked of you in our letter of instructions of 9 November 2022, and the opinions set out in your Original Report; and*
- b) *identify any changes in the opinions expressed in your Original Report and, to the extent required, the reasons for such changes.*
- (c) The third Supplementary Letter of Instructions for this engagement (**Third Supplementary LOI**), dated 27 April 2023 (see Attachment 3 to this Report) instructs me as follows:

Further to the questions set out in our letter of instructions of 9 November 2022 and the instructions in our letters dated 30 March 2023 and 16 April 2023, as part of preparing the Supplementary Report, you are instructed to:

- a) *consider the clarification to our original instructions described in section 2 below; and*
- b) *consider whether the clarification impacts the opinions, analysis or conclusions expressed in your Original Report and, to the extent required, outline the reasons for any changes in the opinions, analysis or conclusions expressed in your Original Report.*

1.2 Given that the matters raised in the SOPV are relevant to the matters raised in the BEN Submission, it will be constructive to start with the matters raised in the SOPV before turning to the matters raised in the Ben Submission. I will address the matters raised in the Third Supplementary LOI last.

2. Relevant Matters Raised in the SOPV

2.1 Matters raised in the SOPV that relate to the questions asked of and addressed by me in my Original Report are contained in sections 5.41 – 5.43 of the SOPV.

2.2 In its Application for Merger Authorisation (**Authorisation Application**)¹, ANZ estimates the incremental capital that APRA will require the merged entity to hold against Suncorp Bank's assets to be in the order of \$1.914 billion. The incremental capital would follow from ANZ's classification (and therefore the merged entity's classification) as a D-SIB. ANZ submits that this incremental capital would benefit both Suncorp Bank's customers and the broader public.

2.3 In section 5.43 of the SOPV the ACCC notes that:

... the greater regulatory requirements on banks designated as D-SIB are intended to reduce the probability of failure compared to non-systemic institutions. However, the ACCC considers that limited material has been provided to date in support of this claimed public benefit and its extent, compared to the future without the Proposed Acquisition. The ACCC's preliminary view is that any improvement in prudential stability arising out of the Proposed Acquisition is unlikely to be substantial.

2.4 Section 5.43 of the SOPV questions the case made by ANZ to support the benefit of the Proposed Transaction arising from the greater regulatory requirements that would be imposed on Suncorp Bank as a result of the Proposed Transaction. In essence, the ACCC questions whether the Proposed Transaction would result in a substantial improvement in Suncorp Bank's prudential safety and soundness.² In reaching its preliminary view, the SOPV notes the observation by the CFA that "*Australia's system for prudential regulation, the*

¹ Section 8.52 of ANZ Proposed Acquisition of SBGH Limited, Application for Merger Authorization, December 2022.

² All references to the impact of the Proposed Transaction in this section are made with reference to the No-Sale Counterfactual. Section 3 below compares the impact of the Proposed Transaction with the Alternative Counterfactual of a Suncorp Bank/BEN merger. While section 3 focuses on a Suncorp Bank/BEN counterfactual in order to address the matters raised in the BEN Submission, the discussion in that section could be applied to an alternative merger of Suncorp Bank with any mid-sized Australian bank.

*banking system and relevant capital benchmarks are already ‘unquestionably strong’ and that “any safety beyond what is required by regulation is unlikely to be significant”.*³

- 2.5 While there is more to prudential safety and soundness than capital, there is universal agreement among regulators that capital is the cornerstone of prudential strength.⁴ The global financial crisis of 2008, in which well-capitalised banking systems (such as those in Australia and Canada) avoided the widespread institutional failures of less-well-capitalised banking systems (such as those in the US and UK), underscored the importance of capital.
- 2.6 As set out in section 2 of my Original Report, APRA’s capital adequacy framework for D-SIBs, including its recent reforms, will result in the following changes in the regulatory capital requirements on Suncorp Bank’s assets under the Proposed Transaction (compared to the No-Sale Counterfactual). These changes follow from the fact that Suncorp Bank will become part of a D-SIB under the Proposed Transaction and are additional to the requirements that Suncorp Bank would face under the No-Sale Counterfactual:
- (a) A reduction in Suncorp Bank’s measured RWA.
 - (b) An additional CCB of 2.25% of RWA to be held as CET 1.
 - (c) A LAC requirement of 3% of RWA which may be held as Tier 2 (while this will not be enforced until January 2024, all Australian D-SIBs are already in compliance with the requirement). The LAC requirement will increase to 4.5% of RWA in January 2026.
- 2.7 As set out in the table in section 8.52 of its Authorisation Application, ANZ estimates that these changes will result in an increase in regulatory capital requirements on Suncorp Bank’s assets of around \$1.9 billion (compared to the No-Sale counterfactual). In my Original Report I opined that, based on my own high-level calculations, this estimate was reasonable.⁵
- 2.8 The question is whether or not this increase in capital required against Suncorp Bank’s assets under the Proposed Transaction would provide a substantial improvement in the safety and soundness of the entity holding those assets. In section 2.3 of my Original Report I opined that it would. The comments below add to the analysis in my Original Report.
- 2.9 In recalibrating its capital requirements in the wake of the 2008 global financial crisis APRA adopted the international practice of separating banks into systemically important banks (D-SIBs) and non-systemically important banks. APRA’s approach was based on the framework proposed by the Basel Committee.⁶
- 2.10 In mitigating the risk of failure of a D-SIB through additional capital requirements, the Basel Committee sought to implement the *“strongly held view of the Group of Twenty (G20)*

³ See section 5.42 of the SOPV.

⁴ See discussion of APRA’s views on capital in my Original Report p. 6.

⁵ See section 2.3 of my Original Report and also section 4 of this Supplementary Report.

⁶ For further details on the role of the Basel Committee in setting international regulatory standards, see section 2.2 of my Original Report.

*leaders, including Australia, that no financial firm should be ‘too-big-to-fail’ and that taxpayers should not bear the cost of resolution.”*⁷ The proposed risk mitigation measures included not only higher capital requirements, but also “*more intensive supervisory oversight ... to increase their resilience to failure*”.⁸

- 2.11 In effect, the Basel Committee’s framework, as implemented by APRA, is based on the principle that the risk mitigating impact of the additional capital measures and more intensive supervisory oversight for a D-SIB should reduce the **risk of failure** of a D-SIB to as low as possible. By implication, the risk of failure of D-SIBs should be substantially lower than the risk of failure of non-systemically important banks, since the latter are not subject to either the additional capital requirements or the more intensive supervisory oversight applied to D-SIBs.
- 2.12 The impact of APRA’s recalibrated capital requirements for D-SIBs is substantial by any measure. As noted in my Original Report, the required ratio of total capital for a D-SIB will, in percentage terms, be 59% higher than that for non-systemically important banks by 2026, when the new requirements will have been fully implemented.⁹ **Not only is this increase substantial, it is the largest increase in capital adequacy requirements in the history of banking regulation.**
- 2.13 By being merged into a D-SIB, Suncorp Bank will, as a result of the Proposed Transaction, be subject to the same additional regulatory requirements as any Australian D-SIB. Thus, under the Proposed Transaction, Suncorp Bank would be subjected to an increase in regulatory capital of almost 60% and also to more intensive supervisory oversight by APRA.
- 2.14 The CFA observes that APRA has sought to establish capital requirements for Australian banks (including non-systemically important banks) that are ‘unquestionably strong’. However, a strong capital position is not a guarantee that a bank will not fail.¹⁰ Banks are in the business of risk and, as the foundation stone of the real economy, banks pool and absorb the many business risks, both internal and external, that face the broader economy. Every bank faces a finite probability of failure under a range of circumstances. While there is no simple, one-for-one mapping of capital adequacy to the probability of a bank’s failure, it is indisputable that, **for any given risk profile**, more capital lowers the risk of failure.
- 2.15 **Thus, while non-systemically important Australian banks may be ‘unquestionably strong’, D-SIBs are ‘unquestionably stronger’.**

⁷ APRA *Information Paper – Domestic systemically important banks in Australia*, Dec 2013, p. 5.

⁸ APRA *Information Paper – Domestic systemically important banks in Australia*, Dec 2013, p. 18.

⁹ Section 2.3 of my Original Report.

¹⁰ That no bank can have a zero probability of failure is a position highlighted by APRA in its *Information Paper – Domestic systemically important banks in Australia*, Dec 2013. In that paper APRA states that: “*designation of a bank as a D-SIB does not make it immune from failure, and shareholders and investors should draw no inferences about public sector support for a D-SIB in the event of distress. Rather, the designation is intended to ensure that banks perceived to be ‘too-big-to-fail’ are subject to more intense supervisory oversight and have greater capacity to absorb losses, to increase their resilience to failure.*”

- 2.16 An increase in required capital of almost 60% compared with the Non-Sale Counterfactual is substantial by any historical comparison and would, in my opinion, reduce the probability of Suncorp Bank's failure by a substantial amount. To argue otherwise would be to argue that APRA has imposed a huge cost on D-SIBs, relative to non-systemically important banks, for no material return in terms of prudential safety.
- 2.17 In addition to increased capital requirements and more intensive supervisory oversight, the Proposed Transaction would result in other changes that would strengthen Suncorp Bank's prudential safety and soundness. In my Original Report I identified considerations such as access by Suncorp Bank to more sophisticated risk management systems from ANZ and benefits from a greater diversification of risks, as factors that would further strengthen Suncorp Bank's safety and soundness.¹¹
- 2.18 In its Authorisation Application, ANZ also pointed to integration efficiencies, productive efficiencies, reduced wholesale funding costs, and greater access to wholesale funding, as factors that would make Suncorp Bank a stronger bank than in the absence of the Proposed Transaction.¹² While the Authorization Application refers to these factors making ANZ a "stronger bank", strength can also add to safety and soundness. For example, greater access to wholesale funding through the larger merged entity would reduce Suncorp Bank's liquidity risk, thereby increasing its safety and soundness. The gains from efficiencies and cost savings would also improve safety and soundness *ex ante* by increasing the resilience of Suncorp Bank to periods in which profit margins may be squeezed. *Ex post*, the gains from efficiencies and cost savings would provide a direct benefit to Suncorp Bank's customers to the extent that the gains and savings are passed on to them in the form of lower borrowing costs.
- 2.19 Given that a substantially lower probability of failure (from the Proposed Transaction) reduces the risk of loss to Suncorp Bank's depositors (most notably, those with deposits above the maximum level of deposits covered by the Australian Financial Claims Scheme),¹³ the Proposed Transaction provides a direct benefit to Suncorp Bank's depositors. The benefit to the broader community through its impact on systemic stability is addressed in section 3 below.

2.20 **Opinion**

It is my opinion that the Proposed Transaction would substantially improve the safety and soundness of Suncorp Bank (compared to the No-Sale Counterfactual). This outcome would follow from:

- (a) an increase in regulatory capital of around 60% and the consequent substantial reduction in the probability of Suncorp Bank's failure;**

¹¹ Section 2.5 of my Original Report. These aspects are taken up further in section 3 below.

¹² Sections 8.6 – 8.39 of ANZ *Proposed Acquisition of SBGH Limited, Application for Merger Authorization*.

¹³ The Financial Claims Scheme is an Australian Government scheme that provides protection to deposit-holders with Australian ADIs (and to insurance policyholders and claimants) in the event that one of these financial institutions fails. The Scheme covers deposits of up to \$250,000 per account holder per ADI. Deposits above this maximum level are not protected by the Scheme.

- (b) **more intensive supervisory oversight of Suncorp Bank’s activities by APRA;**
- (c) **a reduction in the risk of Suncorp Bank’s assets associated with improved diversification and access to more sophisticated risk management systems;**
- (d) **a reduction in liquidity risk associated with greater access to wholesale funding; and**
- (e) **efficiencies and costs saving associated with the merger that would increase Suncorp Bank’s resilience to periods in which profit margins may be squeezed.**

3. Relevant Matters Raised in the BEN Submission

3.1 Matters raised in the BEN Submission that relate to the questions asked of and addressed by me in my Original Report are contained in section 7.4 of the BEN Submission. In that section BEN argues that a merged BEN/Suncorp Bank would pose less systemic risk to Australia’s financial system than would a merged ANZ/Suncorp Bank.

3.2 In addressing the matter of systemic risk BEN makes the following arguments:

- (a) “... any increase in ANZ’s size proportionally increases, not decreases, the amount of systemic risk posed to Australia’s financial system. While the merged entity may be required to hold more regulatory capital (noting that the quantification of this remains highly subjective) than absent the Proposed Acquisition ... such an acquisition may, at best, only balance out the increase in systemic risk, and therefore not amount to a public benefit.”¹⁴
- (b) “... self-reporting from Major Banks following an APRA Inquiry into CBA, whereby Major Banks (including ANZ) identified that they needed to strengthen non-financial risk management, ensure accountabilities are clear and enforced, address long-standing weaknesses and enhance risk culture” contradicted my opinion in my Original Report that “larger banks tend to invest more heavily in risk management systems than smaller banks, and accordingly, a public benefit would follow from Suncorp Bank’s integration with ANZ.”¹⁵
- (c) “... if Suncorp Bank were to merge with a non D-SIB bank, such as BEN, it would arguably have a significantly reduced impact on financial stability than the Proposed Acquisition. This is because the merged entity would not be a D-SIB bank, and would therefore not pose the same systemic risk to Australia’s financial institution.”¹⁶¹⁷

¹⁴ Section 7.4(a) p 48.

¹⁵ Section 7.4(a) p 48.

¹⁶ Section 7.4(b) p 48.

¹⁷ Note: I have quoted the exact wording from the BEN Submission.

3.3 Impact on systemic risk

- (a) In section 7.4(a) of the BEN Submission BEN states, without any supporting evidence or analysis, that the additional capital (associated with the Proposed Transaction) “*may, at best, only balance out the increased systemic risk*”.
- (b) Section 2 above made the case that the Proposed Transaction will strengthen Suncorp Bank’s safety and soundness, thereby reducing its risk of failure and providing a direct benefit to Suncorp Bank’s depositors. The question raised by BEN is whether the increase in safety and soundness also provides a benefit to the broader public, or whether, from a community perspective, the increase in safety and soundness is offset by an increase in systemic risk from the Proposed Transaction.
- (c) It may be helpful to begin this section by clarifying certain terminology related to the concept of systemic risk.
- (d) In managing prudential, regulators typically construct a matrix of risks mapping the **impact** of each risk against the **probability** of that risk being crystalized. The **inherent risk** of an event is the combination of impact and probability before any risk mitigation measures. **Residual risk** is the combination of impact and probability after risk mitigation.¹⁸ This framework of impact, probability and mitigation applies to systemic risk in much the same way that it does to other types of risk.
- (e) The Basel Committee’s framework for assessing systemic risk was mentioned in section 2 above. As noted by APRA, “*the Basel Committee’s D-SIB framework is based on the view that systemic importance should be measured in terms of **the potential impact of a bank’s failure on the economy, rather than the risk that a failure could occur***.”¹⁹ Thus, systemic importance in the context of a D-SIB is a proxy for inherent systemic risk.²⁰
- (f) In measuring the potential impact of a bank’s failure on the economy (i.e., its contribution to inherent systemic risk), international regulators, including APRA, have based their assessments on four main indicators of systemic importance: size, interconnectedness, substitutability, and complexity. While the potential impact of the failure of any bank on the economy is measured (loosely) as a weighted average of the indicators of systemic importance for that bank, each country is afforded considerable discretion in how these weights are applied.²¹

¹⁸ Some regulators construct mathematical models designed to quantify residual risk as a function of impact and probability.

¹⁹ APRA *Information Paper – Domestic systemically important banks in Australia*, Dec 2013, p. 6.

²⁰ Given that inherent systemic risk is the combination of impact of failure and the probability of failure before any mitigation, an increase in systemic importance will, all else equal, have a proportional impact on inherent systemic risk.

²¹ While international regulators, including APRA, publish some details of their D-SIB frameworks, none provides the precise weights used in combining the indicators, nor the cut-off points used in determining when a bank moves from being non-systemic to being a D-SIB.

- (g) Under the Proposed Transaction there would be an increase in the impact on the economy from the failure of the merged entity compared to that of ANZ in the No-Sale Counterfactual. A rough indication of that increase in impact can be derived from the ways in which the four indicators of systemic importance considered by APRA would change under the Proposed Transaction²²:
- (i) **Size** – the first indicator of systemic importance is size. The merged entity would be proportionately larger (as measured by the combined Resident Assets of ANZ and Suncorp Bank the merged entity would be approximately 7% larger than ANZ as a stand-alone bank).²³
 - (ii) **Interconnectedness** – the second indicator of systemic importance is interconnectedness, which is defined in terms of the extent to which banks have financial connections to other financial institutions. APRA considers the following indicators of interconnectedness: loans and advances to financial corporations; deposits from financial corporations; securities outstanding; and large exposures. Based on publicly available data Suncorp Bank would likely add very little to the interconnectedness of the merged entity.²⁴
 - (iii) **Substitutability** – the third indicator of systemic importance is substitutability, which refers to the difficulty that customers may face in gaining access, in a timely manner, to the same or similar services in the event of a failure. APRA considers three main indicators of substitutability: assets under custody; payments activity; and underwritten transactions in debt and equity markets. Based on publicly available data Suncorp Bank would add very little to the substitutability indicator of the merged entity, since Suncorp Bank is not a material participant in the custody or underwriting markets, although it is likely to contribute to payments activity broadly in line with its overall size.²⁵
- (h) OTC derivatives and holdings of trading and available for-sale securities
- (i) **Complexity** - the fourth indicator of systemic importance is complexity, which refers to the extent to which banks are interconnected with the financial system. APRA considers three main indicators of complexity: notional amounts of OTC derivatives; securities available for trading; and RWA for market risk. Much of the data used to assess complexity are not publicly

²² The indicators and how they are measured is set out in APRA *Information Paper – Domestic systemically important banks in Australia*, Dec 2013, p. 8 – 11.

²³ Resident assets are reported in the Annual reports for Suncorp Bank and ANZ for the year ending June 2022.

²⁴ Again, see annual reports for Suncorp Bank and ANZ.

²⁵ The comments about substitutability and complexity in this section are based on the data and comments made by APRA in its *Information Paper – Domestic systemically important banks in Australia*, Dec 2013. While these data and observations may be a little dated, it is very unlikely that there have been major changes since that time in the relativities between Australian banks with respect to the activities reported by APRA in that paper.

available although, in its Information Paper,²⁶ APRA noted that the four major banks are dominant in trading activities related to OTC derivatives and holdings of trading and available for-sale securities, with the fifth largest bank less than half that of the fourth largest bank. In the figures published by APRA on RWA for market risk, Suncorp Bank was the 8th largest bank. Based on publicly available data, it is likely that Suncorp Bank would again add very little to the complexity of the merged entity.

- (i) While the size of the change in systemic importance of the merged entity from the Proposed Transaction is difficult to quantify precisely, there can be little question that it would be positive (compared to the No-Sale Counterfactual). While APRA has not made its weighting structure public, it is reasonable to assume that a proportional increase in **all** indicators would correspond with a similar proportional increase in measured systemic importance and therefore on inherent systemic risk.
- (j) Based on the (admittedly high-level) analysis above, the only indicator that is likely to increase proportionately is size. In each of the other cases, the addition from Suncorp Bank to the measured systemic importance of the merged entity is likely to be quite small, and less than in proportion to the relevant indicators for ANZ bank as a stand-alone entity. Thus, while the Proposed Transaction would add around 7% to the size of the merged entity, the overall increase in systemic importance and inherent systemic risk from the Proposed Transaction is likely to be materially less than 7%.
- (k) The approximate increase in inherent systemic risk from the Proposed Transaction (compared to the No-Sale Counterfactual) of less than 7% compares with an increase in required capital of almost 60%. While these measures are not strictly comparable, the scale of the mitigation measures (including not only capital, but also the additional supervisory oversight and other factors mentioned in section 2) provides a *prima facie* case that the impact of the mitigation measures is likely to more than offset the increase in inherent systemic risk, thereby reducing residual systemic risk.
- (l) This outcome is consistent with the stated objective of the Basel framework for D-SIBs, which is to impose additional prudential requirements on D-SIBs that are sufficiently onerous that they reduce the probability of failure, and therefore the residual systemic risk of a D-SIB, as close to zero as is possible. This objective is clearly articulated in the G20 view that “*taxpayers **should not** bear the cost of resolution*”.²⁷
- (m) By reducing the probability of failure as close to zero as is possible, the risk mitigation measures imposed on D-SIBs are intended to reduce **residual** systemic risk associated with systemically important institutions.
- (n) Thus, while the Proposed Transaction would increase inherent systemic risk (compared to the No-Sale Counterfactual), the merging of Suncorp Bank with an entity that has already been declared to be a D-SIB would result in a substantial

²⁶ APRA Information Paper – Domestic systemically important banks in Australia, Dec 2013.

²⁷ See earlier quote in section 2.

increase in its regulatory capital requirement and prudential oversight. The net impact of these changes would be to reduce the probability of failure of Suncorp Bank and also to reduce the residual systemic risk of both Suncorp Bank and the merged entity.

3.4 Opinion

It is my opinion that the proposed Transaction would provide a benefit to the broader community by reducing residual systemic risk in the Australian financial system.

3.5 Risk management systems

- (a) In section 7.4(a) of the BEN Submission BEN argues that the self-reported weaknesses of the Australian Major Banks in managing non-financial risks contradicts my opinion in my Original Report that larger banks tend to invest more heavily in risk management systems than smaller banks, and accordingly, that a public benefit would follow from Suncorp Bank's integration with ANZ.²⁸ I disagree with BEN that there is a contradiction.
- (b) First, the opinion in my Original Report refers to investment in 'risk management and risk management systems'.²⁹ In that section I was referring to risk management systems generally. While the separation of risks into financial and non-financial is somewhat arbitrary, it is widely understood that financial risks include traditional banking risks such as the measurement and management of credit risk, market risk and liquidity risk, whereas non-financial risks include most other sources of risk to banks. More recently, following APRA's Prudential Inquiry³⁰ into weaknesses in Commonwealth Bank's governance, culture, and accountability, it has become common (at least in Australia) to think of these three areas as the core of non-financial risk, with other areas such as fraud detection, anti-money laundering, and cybersecurity being thought of as parts of operational risk.
- (c) In my Original Report I referred to specific areas of operational and financial risk management in which sophisticated systems are employed by larger banks. I noted that the sophistication of the risk management systems employed by large banks was a key reason underlying the fact that APRA has only accredited larger banks to use the IRB approach to credit.
- (d) While managing non-financial risks (i.e., governance, culture and accountability) has become quite mainstream since APRA's Inquiry into Commonwealth Bank, it is not an area that is as conducive to sophisticated risk management systems as are other, more technical, areas of financial and operational risk management (such as credit risk, market risk, fraud detection, anti-money laundering, and cybersecurity). This is because most aspects of non-financial risk (e.g., culture) are not easily quantifiable. Managing non-financial risk is more a matter of establishing structures and controls

²⁸ The public benefit arises from the reduction in risk levels (improvement in safety and soundness) that follow from using more sophisticated systems to better measure and manage those risks.

²⁹ See section 2.5 of my Original Report.

³⁰ APRA *Prudential Inquiry into the Commonwealth Bank of Australia (CBA) Final Report, May 2018*.

for areas such as: oversight and accountability; clarity and appropriateness of roles; fostering a culture that encourages challenge; and compatible remuneration incentives.

- (e) BEN's statement focuses on the one area of risk management that was not specifically addressed by my Original Report. Since it does not address financial or operational risk management systems, not is it applicable to financial or operational risk management systems, BEN's statement does not contradict my opinion about Major Banks investing more than smaller banks in risk management systems generally (in particular, in financial and operational risk management systems).
- (f) Second, while the APRA Inquiry into CBA and its subsequent request for self-assessment of management of non-financial risks exposed deficiencies in the management of those risks in all Major Banks, each of the Majors has embarked on a multi-year program to address its deficiencies and to strengthen its non-financial risk management and culture.
- (g) Thus, BEN's comment about the state of non-financial risk management by the Major Banks is somewhat dated and not particularly relevant in the current context.
- (h) Third, my opinion about public benefit rested on a comparison of risk management expertise in ANZ and Suncorp Bank. In the context of the BEN's comment, the more relevant comparison would be between non-financial risk management expertise in ANZ and BEN (the Alternative Counterfactual). In the narrow area of non-financial risk management I note that, while APRA's request for a self-assessment of non-financial risk management exposed weaknesses among the four Majors, it also exposed similar weaknesses in smaller banks, such as Suncorp Bank and BEN.
- (i) In summary, BEN's assertion that the self-reported weaknesses of the Australian Major Banks in managing non-financial risks contradicts my opinion in my Original Report that larger banks tend to invest more heavily in risk management systems than smaller banks is flawed in three respects: it focuses on non-financial risk management, and ignores the key areas of risk management raised in my Original Report; even within the narrow area of non-financial risk it fails to acknowledge developments in non-financial risk management that have occurred since the APRA Inquiry; and it fails to acknowledge similar weaknesses in non-financial risk management among non-systemically important banks such as Suncorp Bank and BEN.

3.6 Opinion

I disagree with BEN's argument that the 2019 self-reported weaknesses of the Major Banks in the area of non-financial risk contradicts my opinion that larger banks tend to invest more heavily in risk management systems than smaller banks (and that a public benefit would therefore likely result from integrating Suncorp Bank into ANZ's risk management systems). Not only does BEN's statement fail to address financial and operational risks, but it is somewhat dated and not reflective of the current state of non-financial risk management by Major Banks. It also fails to acknowledge that weaknesses in non-financial risk management were also identified in smaller banks such as Suncorp Bank and BEN.

3.7 Contributions to systemic risk

- (a) In section 7.4(b) of the BEN Submission BEN argues that a merger between Suncorp Bank and BEN would arguably have a significantly reduced impact on financial stability than the Proposed Acquisition.
- (b) While the intended meaning of a 'significantly reduced impact on financial stability' is not entirely clear, I have interpreted this statement as arguing that a merged Suncorp Bank/BEN would make a smaller contribution to residual systemic risk than the Proposed Transaction. Provided my interpretation of BEN's statement is correct, I disagree with BEN's statement.
- (c) The reason suggested by BEN for this outcome is that a merged Suncorp/ANZ would be a D-SIB whereas a merged Suncorp/BEN would not.
- (d) The impact of a Suncorp/ANZ merger on systemic risk was discussed in section 3.1 above. As noted in that section, I agree that a Suncorp/ANZ merger would increase **inherent** systemic risk (the potential unmitigated impact of the merged bank's failure on the economy). However, after accounting for the mitigating effects of the incremental capital that the merged entity would be required to hold (and other risk-mitigating factors), it is my opinion that **residual** systemic risk (the interaction of potential impact with the probability of failure after mitigation) would be lower under the Proposed Transaction than it would be under the No-Sale Counterfactual.
- (e) Assessment of the impact of a Suncorp/BEN merger on systemic risk is more nuanced. When assessing impacts on systemic risk, it is important to recognise that, while regulators divide banks into systemically important and non-systemically important, the reality is that systemic risk is a continuous, rather than a binary, concept. As highlighted by the recent bank failures in the US, any bank can pose some degree of systemic risk, depending on the circumstances. The fact that APRA currently determines that ANZ is a D-SIB and that Suncorp Bank is not, does not mean that Suncorp Bank does not pose some potential systemic risk, nor that a run on Suncorp Bank could never require public intervention. The collapse of SVB in the United States (**US**) and the need for public intervention was a timely reminder that the definition of systemic importance is somewhat arbitrary and can be tested by the circumstances.
- (f) Recognition of the continuum of systemic risk is particularly important when comparing the systemic impact of the proposed Suncorp Bank/ANZ merger with the Alternative Counterfactual of a Suncorp/BEN merger (or other alternative mergers).
- (g) In the case of a Suncorp Bank/BEN merger, there would again likely be some increase in systemic importance and therefore in inherent systemic risk. In terms of the four factors considered by APRA:³¹

³¹ This assessment of the four factors is based on the analysis presented by APRA in its *Information Paper – Domestic systemically important banks in Australia*, Dec 2013, updated where possible from data available in annual reports for 2022.

- (i) Size - the merged entity would be proportionately larger.
 - (ii) Interconnectedness – Suncorp Bank and BEN were quite similar on APRA’s measures of interconnectedness, although neither was rated particularly highly by APRA on any measure.
 - (iii) Substitutability – again, Suncorp Bank and BEN were quite similar on APRA’s measures of substitutability and, again, neither was rated particularly highly by APRA on any measure.
 - (iv) Complexity – again, Suncorp Bank and BEN were quite similar on APRA’s measures of complexity and, again, neither was rated particularly highly by APRA on any measure.
- (h) As with a Suncorp Bank/ANZ merger, the direction of the increase in inherent systemic risk from a Suncorp Bank/BEN merger would be positive. While a Suncorp Bank/BEN merger would increase inherent systemic risk compared to that of the same two banks as stand-alone entities, both the overall level of inherent systemic risk and the size of the increase would likely be quite small.
- (i) However, while the potential mergers of Suncorp Bank with either ANZ or BEN would both involve some increase in inherent systemic risk, only the merger with ANZ would involve mitigation of that risk through the material increase in regulatory capital³² imposed by APRA on D-SIBs.³³ In the absence of mitigation, a merger of Suncorp Bank with BEN (or any other small Australian bank) would unambiguously increase both inherent systemic risk and residual systemic risk (albeit by only a small amount).

3.8 Opinion

It is my opinion that, while the Proposed Transaction would provide a reduction in residual systemic risk compared to the No-Sale Counterfactual, the Alternative Counterfactual of a merger between Suncorp Bank and BEN would unambiguously increase residual systemic risk, because of the absence of any prudential mitigation. Thus, contrary to the assertion in the BEN Submission, a merger between Suncorp Bank and BEN would increase residual systemic risk compared to the Proposed Transaction.

4. Clarification to original instructions re incremental capital estimate

- 4.1 In my Original Report I was instructed to assume that the incremental capital that APRA will require the merged entity to hold against the Suncorp Bank assets would be in the order of

³² See discussion in section 3.1 above.

³³ This assessment assumes that a Suncorp/BEN merger would not be designated a D-SIB by APRA. This assumption is based on a comparison of the merged entity with Australia’s fifth largest bank, Macquarie Bank (which has not been designated as a D-SIB by APRA). While a merged Suncorp/BEN bank would have assets close to \$200 billion, that would still leave it around half the size of Macquarie Bank. Not only would a merged Suncorp/BEN be considerably smaller than Macquarie Bank, but it would also be considerably less complex and less interconnected than Macquarie Bank. Thus, the likelihood of the merged Suncorp/BEN entity being designated a D-SIB by APRA appears very low.

\$1.914 billion.³⁴ This estimate was based on a number of assumptions made by ANZ, including that the *“latest externally reported RWA for Suncorp Bank (as at June 2022) is an appropriate estimation of the additional RWA (risk-weighted assets) that will be subjected to the additional LAC requirement as a result of the Proposed Transaction”*³⁵. The level of Suncorp Bank’s RWA at June 2022 was \$34.797 billion.

- 4.2 The Third Supplementary LOI clarifies that the assumption of unchanged RWA for Suncorp Bank’s assets incorporated an element of APRA’s capital reforms, namely the additional capital conservation buffer (CCB) that would be applied to these assets as a result of their being classified as part of a D-SIB.
- 4.3 The Third Supplementary LOI instructs me to consider the clarification and whether it impacts the opinions, analysis or conclusions expressed in my Original Report.
- 4.4 For the sake of clarity, it is worthwhile reiterating the factors affecting the incremental capital that would apply to Suncorp Bank’s assets as a result of the Proposed Transaction. Since required capital is the product of RWA and prudential capital ratios, the actual capital required can be affected by changes to either of these components.
- (a) Impact of the Proposed Transaction on Suncorp Bank’s RWA³⁶:
- (i) A reduction in RWA resulting from ANZ’s intention to use its IRB approach to calculating RWA for the merged entity.
 - (ii) An increase in RWA resulting from the merged entity being subject to a regulatory capital charge for IRRBB (applied to all D-SIBs).
 - (iii) In addition to these two changes arising from the Proposed Transaction, there will be a further reduction in Suncorp Bank’s RWA arising from APRA’s Capital Adequacy changes (implemented in January 2023). Note that this change is not a result of the Proposed Transaction, although it will affect Suncorp Bank’s RWA.
- (b) Impact of the Proposed Transaction on Suncorp Bank’s Capital ratios:
- (i) An increase in CET 1 of 1.25% applied to all D-SIBs (**incremental CCB**).
 - (ii) An increase in Tier 2 of 3% in 2023 and a further increase of 1.5% in 2026, again applied to all D-SIBs (**incremental LAC**).

³⁴ Annexure A of Letter of Instructions to my Original Report.

³⁵ See paragraph 2.4(a) of Annexure A of Attachment 1 of my Original Report.

³⁶ Definitions of terms and details of calculations can be found in section 2.3 of my Original Report.

- 4.5 In my Original Report I undertook a series of computations to validate ANZ's estimate of \$1.914 billion of incremental capital that would be required as a result of the Proposed Transaction.³⁷ According to my estimates, Suncorp Bank's RWA would be affected by the Proposed Transaction as follows:³⁸
- (a) A reduction in RWA of around \$4 billion due to the move to IRB;
 - (b) An increase in RWA of around \$3.3 billion due to the charge for IRRBB; and
 - (c) A reduction in RWA of around \$2 billion due to APRA's Capital Adequacy changes (unrelated to the Proposed Transaction).
- 4.6 Based on my estimates, I noted that Suncorp Bank's RWA would likely reduce by around \$2.8 billion. While I noted that this was arguably a material decrease in RWA, I was prepared to accept ANZ's assumption of no material change. I accepted that assumption as reasonable on two grounds:³⁹
- (a) first, that my calculations were high-level and not based on the same level of detail available to ANZ; and
 - (b) second, that the impact of the difference in RWA (between ANZ's estimate and mine) on the ultimate amount of required capital was not material.
- 4.7 With respect to the second of these grounds I provided, in my Original Report, estimates of the change in required capital under the assumption given to me (of no change in Suncorp Bank's current RWA from its June 2022 level of \$34.797 billion) and also under my RWA calculations (of a reduction in RWA of around \$2.8 billion, to \$31.997 billion).⁴⁰
- 4.8 In both cases (RWA of \$34.797 billion and \$31.997 respectively), I applied the changes in capital ratios (1.25% to CET 1 for CCB and 3% to Tier 2 in 2023 for LAC, followed by a further 1.5% to Tier 2 for LAC in 2026) to derive estimates of the overall impact of the Proposed Transaction.
- 4.9 As noted on p.9 of my Original Report, even with the lower estimate of \$31.997 billion for Suncorp Bank's RWA, my estimate of incremental capital was \$1.68 billion in 2023, increasing to \$2.16 billion in 2026. Based on those calculations, I opined that ANZ's estimate of the impact of the Proposed Transaction (an increase of \$1.914 billion) was reasonable.
- 4.10 The Third Supplementary LOI clarifies that, in making the assumption that there would be no material change in Suncorp Bank's RWA, ANZ had already netted off the impact of the 1.25% **incremental CCB**, on the grounds that:

³⁷ Section 2.3 of my Original Report.

³⁸ See p. 7 of my Original Report.

³⁹ See p. 8 of my Original Report.

⁴⁰ See p. 8 and p. 9 of my Original Report.

“... the CCB increase has been conservatively excluded to avoid the risk of over-estimating the additional LAC requirements in the event that there is a material reduction in Suncorp’s RWA (contrary to ANZ’s expectations) following implementation of the APRA capital reforms in 2023.”⁴¹

- 4.11 Thus, in calculating the incremental capital requirement, ANZ had excluded the reduction in Suncorp Bank’s RWA arising from APRA’s Capital Adequacy changes (my third point under (a) above). To offset this exclusion, they also excluded the 1.25% incremental CCB.
- 4.12 The explanation provided in the Third Supplementary LOI better justifies ANZ’s assumption that Suncorp Bank’s RWA would not change materially from its June 2022 level of \$34.797 billion. Since my calculations in my Original Report include both of the elements excluded by ANZ, the clarification supports the use of my calculations based on the lower figure of \$31.997 for Suncorp Bank’s RWA.
- 4.13 Thus, I would revise the table for Incremental Minimum Capital Adequacy Ratios on p.8 of my Original Report in the following ways:

Incremental Minimum Capital Adequacy Ratios (D-SIB vs Standardised)

	2022	2023	2026
CET 1:			
CCB	1%	1%	1%
Additional CCB for D-SIBs		1.25%	1.25%
Tier 2:			
LAC for D-SIBs*	3%	3%	4.5%
RWA (Suncorp Bank):	\$34.797 b \$31.997 b	\$34.797 b \$31.997 b	\$34.797 b \$31.997 b
Incremental Total Capital	\$1.39 b \$1.36 b	\$1.83 b \$1.68 b	\$2.25 b \$2.16 b

- 4.14 As noted on p.9 of my Original Report, these estimates are consistent with ANZ’s estimate of \$1.979 billion by the end of the transition to APRA’s new rules.
- 4.15 Therefore, I see no reason to amend my original opinion.
- 4.16 **Opinion**

Based on my high-level calculations, I find ANZ’s estimate of the impact of the Proposed Transaction on Incremental Capital to be reasonable.

⁴¹ Paragraph 2.1(b) of Third Supplementary LOI.

Attachment 1

Supplementary Letter of Instruction from Ashurst Australia, dated 30 March 2023

Our ref: [REDACTED]
Partner: Tihana Zuk
Direct line: [REDACTED]
Email: [REDACTED]

Ashurst Australia
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30 March 2023

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BY EMAIL TO: [REDACTED]

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Dr Jeffrey Carmichael
[REDACTED]



Dear Dr Carmichael

We refer to our letter of engagement to you dated 28 August 2022 and our letter of instructions dated 9 November 2022.

We previously sought your expert opinion, in the form of a written report, in connection with the Authorisation Application, and you prepared a report dated 25 November 2022 (**Original Report**).

As part of the ACCC's public consultation process in relation to the Authorisation Application, the ACCC has sought submissions from third parties regarding the Proposed Transaction. Relevantly, Bendigo and Adelaide Bank (**BEN**) has made a submission to the ACCC, a public version of which has been made available on the ACCC's public register (**BEN Submission**). The BEN Submission addresses, among other things, prudential safety and aspects of your Original Report.

The purpose of this letter is to request you to prepare a supplementary expert report in this matter, in light of the BEN Submission, which will address the questions below.

1. INSTRUCTIONS

1.1 Further to the questions set out in our letter of instructions of 9 November 2022, you are instructed to prepare a further written report, which:

- (a) addresses the matters raised in the BEN Submission in so far as they relate to the questions asked of you in our letter of instructions of 9 November 2022, and the opinions set out in your Original Report; and
- (b) identifies any changes in the opinions expressed in your Original Report and, to the extent required, the reasons for such changes.

2. BACKGROUND DOCUMENTS

2.1 In preparing your supplementary report, please rely on the documents listed in Schedule 1.

3. EXPERT WITNESS CODE OF CONDUCT

3.1 You are instructed to prepare your supplementary report in accordance with the requirements of the Practice Note and the Code, which were provided to you with your engagement letter. You are expected to be objective, professional and to form an independent view regarding matters relevant to your analysis. It is important that you

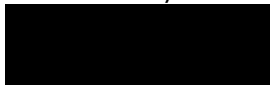
carefully read and comply with the Code. We note that under the Code, your report must clearly state the following:

- (a) your name and address;
- (b) an acknowledgement that you have read this code and agree to be bound by it;
- (c) your qualifications as an expert to prepare the report;
- (d) the assumptions and material facts on which each opinion expressed in the report is based (this letter of instructions may be annexed);
- (e) the reasons for and any literature or other material utilised in support of each such opinion;
- (f) (if applicable) that a particular question, issue or matter falls outside your field of expertise;
- (g) any examinations, tests or other investigations on which you have relied, identifying the person who carried them out and that person's qualifications;
- (h) the extent to which any opinion which you have expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;
- (i) a declaration that you have made all the inquiries which you believe are desirable and appropriate (save for any matter identified explicitly in the report), and that no matters of significance which you regard as relevant have, to your knowledge, been withheld from the court;
- (j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;
- (k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and
- (l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

We look forward to receipt of your supplementary report in due course.

Please contact Tihana Zuk if you require any further information.

Your sincerely



Ashurst

SCHEDULE 1

No	Document Description	Link
1	Bendigo and Adelaide Bank submission	Bendigo and Adelaide submission and attachments - 03.03.23 - PR VERSION - MA1000023 ANZ Suncorp.pdf (acc.gov.au)
2	Stephen King expert report prepared for Bendigo and Adelaide Bank, to accompany its submission	Bendigo and Adelaide submission – Stephen King expert report - 03.03.23 - PR VERSION - MA1000023 ANZ Suncorp.pdf (acc.gov.au)

Attachment 2

Supplementary Letter of Instruction from Ashurst Australia, dated 16 April 2023

Our ref: [REDACTED]
Partner: Tihana Zuk
Direct line: [REDACTED]
Email: [REDACTED]
Contact: John McKellar
Direct line: [REDACTED]
Email: [REDACTED]

16 April 2023

BY EMAIL TO: [REDACTED]

Dr Jeffrey Carmichael
[REDACTED]

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Dear Dr Carmichael

We refer to our letter of engagement to you dated 28 August 2022, our letter of instructions dated 9 November 2022 and our letter of instructions for a supplementary report dated 30 March 2023.

We previously sought your expert opinion, in the form of a written report, in connection with the Authorisation Application, and you prepared a report dated 25 November 2022 (**Original Report**).

In our letter of instructions dated 30 March 2023, we sought your expert opinion on certain matters raised in Bendigo and Adelaide Bank's submission to the ACCC (**Supplementary Report**). On 4 April 2023, the ACCC published a Statement of Preliminary Views (**SOPV**). The SOPV addresses, among other things, the public benefits claimed in the Authorisation Application.

The purpose of this letter is to provide additional instructions in relation to the Supplementary Report.

1. INSTRUCTIONS

1.1 Further to the questions set out in our letter of instructions of 9 November 2022 and the instructions in our letter dated 30 March 2023, as part of preparing the Supplementary Report, you are instructed to:

- (a) address the matters raised in the SOPV in so far as they relate to the questions asked of you in our letter of instructions of 9 November 2022, and the opinions set out in your Original Report; and
- (b) identify any changes in the opinions expressed in your Original Report and, to the extent required, the reasons for such changes.

2. BACKGROUND DOCUMENTS

2.1 In preparing your Supplementary Report, please rely on the document listed in Schedule 1 (in addition to the documents listed in our letter dated 30 March 2023).

3. EXPERT WITNESS CODE OF CONDUCT

3.1 You are instructed to prepare your Supplementary Report in accordance with the requirements of the Practice Note and the Code, which were provided to you with your engagement letter. You are expected to be objective, professional and to form an independent view regarding matters relevant to your analysis. It is important that you

carefully read and comply with the Code. We note that under the Code, your report must clearly state the following:

- (a) your name and address;
- (b) an acknowledgement that you have read this code and agree to be bound by it;
- (c) your qualifications as an expert to prepare the report;
- (d) the assumptions and material facts on which each opinion expressed in the report is based (this letter of instructions may be annexed);
- (e) the reasons for and any literature or other material utilised in support of each such opinion;
- (f) (if applicable) that a particular question, issue or matter falls outside your field of expertise;
- (g) any examinations, tests or other investigations on which you have relied, identifying the person who carried them out and that person's qualifications;
- (h) the extent to which any opinion which you have expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;
- (i) a declaration that you have made all the inquiries which you believe are desirable and appropriate (save for any matter identified explicitly in the report), and that no matters of significance which you regard as relevant have, to your knowledge, been withheld from the court;
- (j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;
- (k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and
- (l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

We look forward to receipt of your Supplementary Report in due course.

Please contact Tihana Zuk if you require any further information.

Your sincerely



Ashurst

SCHEDULE 1

No	Document Description	Link
1	ACCC Statement of Preliminary Views	SOPV (acc.gov.au)

Attachment 3

Supplementary Letter of Instruction from Ashurst Australia, dated 27 April 2023

Our ref: [REDACTED]
Partner: Tihana Zuk
Direct line: [REDACTED]
Email: [REDACTED]
Contact: John McKellar
Direct line: [REDACTED]
Email: [REDACTED]

27 April 2023

BY EMAIL TO: [REDACTED]

Dr Jeffrey Carmichael
[REDACTED]

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Dear Dr Carmichael

We refer to our letter of engagement to you dated 28 August 2022, our letter of instructions dated 9 November 2022 and our letters of instructions for a supplementary report dated 30 March 2023 and 16 April 2023.

We previously sought your expert opinion, in the form of a written report, in connection with the Authorisation Application, and you prepared a report dated 25 November 2022 (**Original Report**).

In our letters of instructions dated 30 March 2023 and 16 April 2023, we sought your expert opinion on certain matters raised in Bendigo and Adelaide Bank's submission to the ACCC and the ACCC's Statement of Preliminary Views.

The purpose of this letter is to provide additional instructions in relation to the Supplementary Report.

1. INSTRUCTIONS

- 1.1 Further to the questions set out in our letter of instructions of 9 November 2022 and the instructions in our letters dated 30 March 2023 and 16 April 2023, as part of preparing the Supplementary Report, you are instructed to:
- (a) consider the clarification to our original instructions described in section 2 below; and
 - (b) consider whether the clarification impacts the opinions, analysis or conclusions expressed in your Original Report and, to the extent required, outline the reasons for any changes in the opinions, analysis or conclusions expressed in your Original Report.

2. CLARIFICATION TO ORIGINAL INSTRUCTIONS

- 2.1 The assumption in paragraph 2.4(a) of the letter of instructions dated 9 November 2022 regarding RWA requires clarification. Could you please have regard to the following, clarified, assumptions instead of those outlined in paragraph 2.4 of the letter of instructions dated 9 November 2022:
- (a) **RWA (excluding APRA capital reforms impact):** The latest externally reported RWA for Suncorp Bank (as at June 2022) is an appropriate estimation of the additional RWA that will be subjected to the additional LAC requirement as a result of the Proposed Transaction. ANZ's due diligence in respect of Suncorp Bank indicates that the combined impacts from the IRRBB RWA capital requirements and APRA's accreditation to use the internal ratings-based (**IRB**) approach for calculating RWA

(refer to details in 2.5 below) would not result in any material change to Suncorp Bank's RWA.

- (b) **CET1:** Table 1 [in Annexure A] does not include the additional 1.25% increase in the Capital Conservation Buffer (**CCB**) for major banks arising from APRA's capital reforms. This increase in CCB is a calibration outcome as part of the capital reforms to ensure capital levels (measured in dollar terms) for major banks are not reduced as a result of the expected reduction in RWA following APRA's reforms. Prima facie, while it would be applicable to the analysis in Table 1, the CCB increase has been conservatively excluded to avoid the risk of over-estimating the additional LAC requirements in the event that there is a material reduction in Suncorp's RWA (contrary to ANZ's expectations) following implementation of the APRA capital reforms in 2023.
- (c) **APRA capital reforms impact on RWA:** In estimating the incremental LAC figure of \$1.914bn, ANZ has not included the impact from the potential reduction in RWA arising from the APRA capital reforms. This is for consistency with ANZ's assumptions regarding CET-1 buffers, which do not include a further increase of 1.25% relating to higher CCB for D-SIBS. ANZ has assumed that the combined impact of the higher CCB, and potential reduction in RWA arising from APRA capital reforms, on LAC would be immaterial or broadly neutral. This assumption is based on APRA's 2020 Discussion Paper¹, which provides that the higher CCB is a calibration outcome to offset the impact of potentially lower RWA arising from the APRA capital reforms to ensure capital levels (measured in dollar terms) for D-SIBS are not reduced.
- (d) **Tier 2:** The incremental Tier 2 LAC of 4.5% of RWA reflects APRA's fully transitioned additional LAC requirements for major banks, which would take effect by January 2026. APRA has adopted a phased approach to its implementation of higher LAC requirements with 3% of RWA (~\$1 billion) required by January 2024 (which would be the requirement in-force at completion of the Proposed Transition) and the remaining 1.5% (~\$0.5 billion) increment to take effect by January 2026. However, in practical terms, and subject to market conditions, ANZ will likely meet the new Tier 2 requirement well in advance of 1 January 2026 to minimise the risk of non-compliance with ARPA's deadline.

2.2 For ease of reference, we have shaded in grey the amended / new text.

3. **EXPERT WITNESS CODE OF CONDUCT**

3.1 You are instructed to prepare your Supplementary Report in accordance with the requirements of the Practice Note and the Code, which were provided to you with your engagement letter. You are expected to be objective, professional and to form an independent view regarding matters relevant to your analysis. It is important that you carefully read and comply with the Code. We note that under the Code, your report must clearly state the following:

- (a) your name and address;
- (b) an acknowledgement that you have read this code and agree to be bound by it;

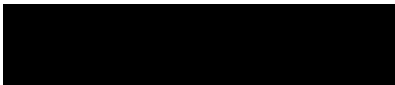
¹ See APRA Discussion Paper "A more flexible and resilient capital framework for ADIs", 8 December 2020, page 15, available at: <https://www.apra.gov.au/sites/default/files/2020-12/Discussion%20paper%20-%20A%20more%20flexible%20and%20resilient%20capital%20framework%20for%20ADIs.pdf>, and APRA paper "Response to Submissions – Finalising the Bank Capital Reforms", November 2021, available at: <https://www.apra.gov.au/sites/default/files/2021-11/Response%20to%20submissions%20-%20Finalising%20bank%20capital%20reforms.pdf>.

- (c) your qualifications as an expert to prepare the report;
- (d) the assumptions and material facts on which each opinion expressed in the report is based (this letter of instructions may be annexed);
- (e) the reasons for and any literature or other material utilised in support of each such opinion;
- (f) (if applicable) that a particular question, issue or matter falls outside your field of expertise;
- (g) any examinations, tests or other investigations on which you have relied, identifying the person who carried them out and that person's qualifications;
- (h) the extent to which any opinion which you have expressed involves the acceptance of another person's opinion, the identification of that other person and the opinion expressed by that other person;
- (i) a declaration that you have made all the inquiries which you believe are desirable and appropriate (save for any matter identified explicitly in the report), and that no matters of significance which you regard as relevant have, to your knowledge, been withheld from the court;
- (j) any qualifications on an opinion expressed in the report without which the report is or may be incomplete or inaccurate;
- (k) whether any opinion expressed in the report is not a concluded opinion because of insufficient research or insufficient data or for any other reason; and
- (l) where the report is lengthy or complex, a brief summary of the report at the beginning of the report.

We look forward to receipt of your Supplementary Report in due course.

Please contact Tihana Zuk if you require any further information.

Your sincerely



Ashurst