HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

REVIEW OF THE FOUR MAJOR BANKS

NAB

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Mr FALINSKI: Sorry to interrupt, but I will get cut off. As a member of parliament, what are the two or three publicly available data points that I should be looking at, in your view?

Mr Dooley: The level of impaired customers in each of the portfolios—the 90 days past due—and what's happening in terms asset quality. What's happening in terms of risk weights is another indicator. You'll have good customers whose risk profile will change. That's reflected in how much capital we hold. Looking at what we call risk density—it's a very technical term, and I apologise for that—will show what's happening in terms of risk profile.

Mr FALINSKI: We will keep an eye on that. If it were possible for you to furnish the committee—even, again, on a confidential basis—with what levels you think we, as a committee, should be aware of, if numbers fall, that would be very helpful.

Answer:

The key metrics we believe should be considered when monitoring credit quality are:

- Percentage of Credit Portfolio that is 90 Days Past Due
- Ratio of Credit Risk Weighted Assets (RWA) to Exposure At Default (EAD)
- Credit Impairment Charges (CIC) as a percentage of the Credit Portfolio.

Below we have outlined the definition of each metric and the method of calculation.

1. <u>Percentage of the Credit Portfolio that is 90 Days Past Due</u>
    - The percentage is calculated as the balance of loans greater than 90 Days Past Due divided by Gross Loans and Acceptances (GLAs).
    - A loan is defined as 90 Days Past Due when it is 90 days or more behind in its contractual obligations (e.g. 90 days late in making a mortgage payment).
    - Gross Loans and Acceptances (GLAs) are the total loans, advances and acceptances, including unearned and deferred fee income, excluding associated provisions for expected credit losses.
    - The trend is of importance in this key metric as an increase over time means a larger number of customers are falling behind in their loan obligations.

2. <u>Ratio of Credit Risk Weighted Assets (RWA) to Exposure At Default (EAD)</u>
    - The Credit Risk Weighted Asset (RWA) of a loan transaction is a measure of the credit risk associated with that transaction. RWAs are calculated based on inputs including the Probability of Default (PD) (i.e. how likely it is that a loan will default), the Loss Given Default (LGD) (i.e. the expected loss should a loan default) and time to maturity (i.e. how long before the loan matures/expires).
    - Exposure at Default (EAD) represents the expected credit exposure for the bank at the time of default and is in most instances the loan limit.
    - The ratio of RWA to EAD is therefore a measure of the relative riskiness of a loan, based on its underlying characteristics.
    - The trend is again important as an increase in the RWA to EAD ratio across a portfolio of loans broadly suggests an increase in the underlying riskiness of the loan (driven by changes

in the PD and LGD), or a change in mix as different customer types, products etc. will generally have different RWA to EAD ratios.

3. Credit Impairment Charges (CIC) as a percentage of the Credit Portfolio
   - Credit impairment charges (CICs) are expenses charged to the Income Statement as a result of credit losses. The CIC provides a view of the impact of changes in credit quality over a period.
   - The percentage is calculated as the CIC divided by the GLAs.
   - An increase in the percentage would indicate declining credit portfolio health. The trend should again be observed to determine whether there is deterioration.