The banking sector has an important role in underpinning Australia's economic stability, but it faces many challenges, from credit defaults to challenges around technological innovation and regulatory pressures. This case study will examine Westpac Banking Corporation, one of Australia's "big four" banks, to evaluate its credit risk profile, compare its performance to peers, and address how Westpac's risk management in technology, modelling, and data risk must transform to leverage Artificial Intelligence (AI) technology without compromising the efficacy of the bank's risk management system. The report draws on Westpac's Annual Report for 2024, its Pillar 3 capital disclosures along with reports from other Big Four banks (CBA, ANZ, and NAB) and insights from APRA.

Westpac applies IFRS 9 standards to classify loans into three credit risk stages. Stage 1 is for assets that have not experienced an increase in credit risk and require a provision for expected credit losses (ECL) within 12 months. Stage 2 applies to assets that have experienced an increase in credit risk but are still performing and require lifetime ECL coverage. Finally, Stage 3 includes defaulted assets, such as assets that are 90 days past due or in default. Due to higher impaired exposures in the mortgage portfolio and other sectors such as wholesale and retail trade and manufacturing, gross impaired exposures to gross loans were seven basis points higher at 0.24% (Westpac, 2024). Additionally, total stressed exposures increased from 1.26% in 2023 to 1.45% in 2024. Furthermore, total loans reached A$806.8 billion, up about 4%, of which 87.9% were concentrated in Australia, with home loans accounting for 70.1% of the portfolio. Moreover, the increase in inflation and interest rates led to an 0.24% increase in mortgages 90+ day delinquencies to 1.05% in 2024 To ease the pressure on borrowers, Westpac implemented 47,500 hardship and disaster support plans during the year; however, 19,000 accounts were still in difficulty by year-end, showing the bank is still facing repayment challenges despite its efforts to cope.

Westpac mitigates credit risk through enterprise-wide stress testing, which functions as the hub of its risk strategy. According to Westpac Pillar 3 in 2024, the Board-level Stress Testing Committee and BRC sign off on the Group framework, review results, and direct remedial actions. The stress scenarios are based on information provided from APRA, including a 4% decline in GDP, a 10% increase in unemployment, and a 35% fall in mortgage rates. The results show that under these extreme conditions, Westpac’s CET1 Ratio would fall by 330 basis points but would still be above the regulatory minimum (APRA Chair speech, lines 32-38). In fact, Westpac has set a “buffer zone” for CET1 at 11-11.5%, and at the end of FY24, this figure was at 12.49%, reflecting the bank’s strong capital position. Total provisions remain A$1.5 billion, about the base-case ECL and Stage 3 coverage of around 45%, 4 basis points of average loans (Investor Discussion Pack p.50). From May 2024, Westpac adjusted mortgage assessment buffers from the standard 3 percentage points to lower to reduce risks for "mortgage-prison" while still being able to stabilize good credit history hurdles (YourMortgage, 2023). Stress testing confirmed this targeted concession has immaterial capital impact. Along with these measures, Westpac deployed dynamic modules with higher-frequency scenario refresh capturing liquidity and ratings shocks, model recalibration with residential-mortgage and corporate PD/LGD upgrades that trimmed unwarranted RWA inflation, and governance uplift through completion of the CORE program that led APRA to cut the operational-risk add-on by A$0.5 billion in July 2024 (APRA media release, 2024).

When comparing Westpac to the other big banks in Australia (CBA, NAB, and ANZ), although not in the lead, Westpac has a strong capital adequacy and a stable write-off profile in recent years, demonstrating effective credit risk management. The stage 3 loan ratio is 1.27%, lower than NAB's 1.33% but higher than CBA's and ANZ's 0.99% and 0.88% respectively. This suggests that the bank's credit quality is unstable and there may be internal risks. However, Westpac has compensated for this through a more conservative provision with a provision coverage ratio of 16.8%, which is lower than NAB with 18.9% but higher than CBA with 16.3% and ANZ with 11.0%, showing that Westpac has a good buffer against possible losses. For expected credit loss provision (ECL), Westpac is in the middle with 0.63%, not as conservative as NAB (0.8%) but higher than that of ANZ and CBA, which is around 0.47%, showing that Westpac sees the overall credit risk and has a strategy to manage the risk prudently. Notably, Westpac's CET1 ratio is quite superior to that of its competitors, with 12.49% in 2024, demonstrating that the bank's capital structure is healthy and able to cope with credit risks. Finally, Westpac kept its net write-off ratio stable at 0.05% showing that despite the decline in credit management quality, it still has a strong and stable underwriting strategy.

The rise of artificial intelligence has brought challenges and risks to banking risk management. In Westpac’s annual report in 2024, they noted technology-related risks, particularly operational risks, model risks, and information security risks as areas of focus. Westpac spent A$2.765 billion in 2024 on technology and digital, accounting for about 25.3% of its operating expenses. While AI significantly enhances customer experience, fraud detection, and credit approval efficiency, the bank still faces emerging risks, including model bias, data bias, and black box decision-making (Financial Stability Board, 2024). Westpac currently relies on model validation and performance back-testing mechanisms. However, its annual report did not mention anything about AI systems or ethics-related arrangements, suggesting that its AI risk management is far from complete (APRA, 2023). To enhance the ability to respond to technological risks, banks should increase model transparency, control data quality, and implement human intervention mechanisms in making important decisions. Technological innovation must develop in parallel with management capacity to maintain credit stability and customer trust.

In conclusion, Westpac's credit risk management has been shaped and proven through rigorous stress tests, conservative provisions, and high capital buffers, thereby affirming the bank's position as well as the reason why Westpac is among the big four banks in Australia. Although Westpac's credit quality has declined in recent years and is still lower than that of big banks such as NAB or CBA, its capital strength and the way the bank handles risk issues show that they have a different direction but still maintain their management ability. In addition, to maintain competitiveness and reputation in the future, Westpac must develop and promote risk activities in line with changes and breakthroughs in technology, integrate AI into corporate governance and operations as well as ensure data and regulation to ensure innovation and increase the bank's risk management ability in the race to become one of the most prestigious banks in Australia.

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