Question and Answer

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. A question on -- nice surprise on impairment charges and the 4 names. Just based on the provision coverage that you've got for individually assessed provisions, and I know you don't talk about provisions on individual names, but the math seems to indicate across the 4 names that you're providing around about 50% of the exposure. So my question is, why is that the correct number? What are the -- what is the security that you have that has been reported that there are a number of names where there is -- it's unsecured lending, and the extent to which that 50% could be deemed to not be enough and there's further provisions required in the second half or beyond?

Peter Francis King
Chief Financial Officer

I think we'll -- I'm not going to touch on the security piece because I think that's getting into customer information, but we go through a process on any name, where we look at the information, their plans and make an assessment. And that's the standard process that we go through, whether it's a big name or a small name. And having had that information on the clients in question, we've assessed through our normal processes the provisions that we require. And as you highlight, that's ended up with a coverage ratio for impaired assets at 48%. So it's based -- at a point in time, it might be better. It -- yes, it might be better or it could be a little bit worse. We'll just have to see how those plans play out.

Andrew Bowden
Head of Investor Relations

Andrew?

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Andrew Lyons from Goldman Sachs. Just a question on the WIB business again, and focusing particularly on the ROE. Page 126, just around the economic profit guidance that you gave, it highlights that the ROE for the WIB business went from 14.2% down to 10.3%, with a good chunk of the delta being driven by the bad debt charge moving towards at 47 basis points, which we would sort of see as around close to mid-cycle sort of across-the-cycle averages. Can you maybe just talk about some of the levers that you have to pull to increase that ROE? Obviously, you've got the group ROE target of 15%. Just keen to sort of see how you balance the portfolio and the degree of comfort that you have around that WIB return of 10%?

Brian Charles Hartzer
MD, Group CEO & Director

So WIB's being affected by both cyclical and structural factors. Some of the cyclical stuff relates to the liquidity issues that we've seen in the markets. That's really affecting the margins, which has been the main drag. And there, the best that we can do is be -- trying to manage the portfolio overall in a way that gives us an acceptable outcome for the cycle. And our primary focus there is protecting long-term relationships that we've got. What it's meant is that there have been some transactions that have been more debt without cross-sell or debt without a strong relationship angle that we've stepped away from. We've also taken action on costs, as you know, which helps deal with some of the structural factors. And some of the work in the markets area, we would hope that as markets improve, we'll see benefits on the revenue side there as well. I guess the important thing to remember is that the overall ROE target is a company level target, and we have a portfolio of businesses. And each business within it has portfolios and segments and customers. And the challenge for each of our divisions is to get that to a level where the whole makes sense. And Lyn and her team are very focused on that.

Andrew Bowden
Head of Investor Relations

Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. On Slide 17, you provide a bit of a breakdown on the NIM, and I think a lot of the focus always goes to that breakdown where customer deposits were up. But if you look at the bottom, beneath that, you really see some very big differences in the divisions, with the Consumer Bank, as you'd expect, up pretty rapidly given the repricing. And for -- but New Zealand, which we know we've talked about and went down quite sharply. If we roll forward without another repricing round coming through, you called out that Consumer's going to be tougher next half and a lot of competition coming through there. Yet with QA [ph], a lot of this liquidity is staying in the Institutional business, it's hard to see that improving rapidly. So if you look at it bottom-up through the divisions, is it fair to assume that NIM pressure is going to probably intensify from here and you're going to continue to see the group NIM flow down? And beyond that, another question, something that came out was you did call the customer deposit spread up. But we saw a big change in the use of TDs through the period. And I think in the last couple of periods, you've been writing down TDs. This period, it's up 11%. So can you firstly talk about the divisional impact? And secondly, what's going on with term deposits?

Peter Francis King
Chief Financial Officer

I'll just deal with the deposit. Often through a cycle, we'll get movements from online to term deposits, depending on relative rates. And we're just getting to a period where term deposits are better for customers, so that tends to see the money flying between the 2. In terms of the transfer pricing on them, one of them is transfer priced off a market rate and one off a cash rate. So that helps there as well. I think you summarized some of the challenges that we've got there right in terms of the margin. So if I look at the different markets, the short-term wholesale market, or BBSW, has increased in the 6 months, and there's some averaging that come through there so that -- and that flows through quickly given its average maturity periods. Long term, costs went up quite a lot, but then they've backed off a little bit. But they take time to come into the group margin because you're rolling not as much. And then I think on the lending side, there is competition. I can't comment on future pricing of lines, obviously, but there is competition. I think it's probably come off a little bit in terms of the competition, particularly in the mortgage book. But yes, there's a few moving pieces that we're negotiating at the moment on margins.

Andrew Bowden
Head of Investor Relations

We'll take one off the phone from Matthew Wilson, please.

Matthew Wilson
JCP Investment Partners Limited

Just let me ask 3 questions, if I may. And are you able to confirm whether you and your management team have signed the banking and finance act?

Brian Charles Hartzer
MD, Group CEO & Director

It's something that we've been looking at, Matthew. Certainly, we agree with all the things that are in there. I guess we haven't, at this point, made it something that's mandatory or made a big push on it, but it is something that we're considering.

Matthew Wilson
JCP Investment Partners Limited

Could you maybe sort of tie it in with your service leadership strategic priority? And obviously, BTIM area, one of your directors is on the policy council.

Brian Charles Hartzer

MD, Group CEO & Director

Yes, well, we've been on the record that we absolutely support the notion that the community expect -- has a right to expect high standards of behavior from banks and from bankers. The question of whether one goes down a particular PR initiative is another question. But we certainly have no objection to the points that are in that.

Andrew Bowden
Head of Investor Relations

We'll take a call from Craig as well. Craig Williams?

Craig Anthony Williams
Citigroup Inc, Research Division

Your payout ratio this half has risen, I think, courtesy of flat dividend and falling earnings. That seems sustainable, assuming sort of 2 very big factors. One, which is your risk-weighted assets growth remained at a seemingly very low level of 1% growth, remembering that there's sort of procyclical risk factors, undue reliance on sort of mortgage credit as the source of growth this half and higher risk weights coming in from July on your new growth in mortgages. And the second factor being that, perhaps, you don't require any higher level on CET1 capital. So can you elaborate on your thoughts on each of the influences and, therefore, your prospects of maintaining your dividends at these levels?

Peter Francis King
Chief Financial Officer

I think, Craig, on the first one, you're right to highlight that RWA growth is quite important, and I think one of the things there will be credit quality. And we haven't seen outside of the 4 names anything that is seeing us get too worried about the outlook. So that will then mean it's a mix of growth between mortgages and business, and we still think mortgages will grow a little bit faster than business. You're right to highlight that all these factors are changing as we look at the Basel proposals and then what APRA will do. But we'll just have to phase into those once we get a bit more clarity. Then your second question about was, if higher capital levels eventuate from the Basel changes, I think it's something that we always -- you've seen us in the past, think about capital and returns, so we'll be looking at what it means from high capital if we get higher risk weights and then how do we get a return on it. And we feel like there's a lot of uncertainty at the moment, so it's not the time to do anything about it. So but again, we'll probably have more information next year, maybe later this year, but certainly next year, and that will be the point that we'll think about it.

Andrew Bowden
Head of Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Rich Wiles, Morgan Stanley. Slide 23 shows capital. The raising last year boosted your position by 96 basis points. But today, you've disclosed that the changes to mortgages will actually reduce capital by 130 basis points. So your pro forma ratio is sitting at 9.2%, which is lower than it was 6 months ago. It looks like you've given up your position of leadership on capital relative to your peers. I just have 2 questions relating to that. Firstly, why weren't you more proactive with the DRP, perhaps, partial DRP underwriting or even keeping a discount on the DRP to boost your capital? And secondly, if APRA does come out with its response to the Basel changes in 2017, do you genuinely believe that implementation will start the following year? Or do you think that it will need to start as soon as the market finds out where we're heading?

Peter Francis King
Chief Financial Officer

Well, in terms of the positioning of the capital, we think about it through the preferred range lens. So that -- we wanted to be at the top end of the preferred range last half, and that's where we've ended up this half. We're a little bit above at last half. We're a little bit below this half. So that's how we fought through that particular issue. I think everyone is focused on one lever here in terms of responding to Basel, and that is raising capital. There will be other levers. We'll have to look at the businesses, look at them through the NSFR lens, through the capital lens and, potentially, we have to reshape some of these businesses for the times. So I think that's going on at the same time. And one of the challenges we have as a management team is the rules aren't clear. We're doing our best to work out where they're going to land and think about what we want to do. But as an example, limits -- unused limits in products become very expensive from a capital liquidity perspective, so we need to think through what and how you design products for the new world. And that's why I think there's time for us to think through both of those, and we're active in both of those.

Andrew Triggs
Deutsche Bank AG, Research Division

It's Andrew Triggs from Deutsche Bank. Just the first question on the NSFR, you said a little bit below where you need to be. Just an idea as to whether you think there's a lengthening of wholesale funding that needs to be done or a boost to deposits? And secondly, just a follow-up on WIB returns. Is there still a material -- given that, I presume, there's a -- there are some high-ROE products within that division, such as transaction banking, presumably, that the lending portfolio would be well sub-10% ROE now on an economic capital basis? Is that the case?

Peter Francis King
Chief Financial Officer

So on the WIB portfolio, I think we always look at the customer perspective. And so the team in WIB are drilling down and looking at all returns across relationships, and that's an example of looking at different segments. So a segment that is very lending orientated will have a lower ROE than one that has a full suite of products in it. And so that gives you a bit of a sense of how we're starting to think about that or how we thought about it but how we're sharpening up the thinking for that Institutional business. Sorry, what was your first?

Andrew Triggs
Deutsche Bank AG, Research Division

On NSFR, how do we get to the 100%?

Peter Francis King
Chief Financial Officer

Yes, on NSFR, it'll be a combination of restructuring and liquidity portfolio. It could be some lengthening of the term profile. It could be some -- depending on where we end up, it could be changes to the customer balance sheet. So we'll just -- all those 3 levers are there. We need the final regulations before we can work out what we need to do.

Brian Charles Hartzer
MD, Group CEO & Director

Might I just add a little clarification on the WIB point, which is that we manage the pricing at a customer level, and so it's kind of artificial to say lending versus the other because we actually do it together when we're looking at an individual relationship.

Andrew Bowden
Head of Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

I have 2 questions, if I may. Brian Johnson, CLSA. The first one is if we have a look on -- and I just want to preface this by a lot of the narrative from the banks has been with the way the accounting works is, as the loan portfolio deteriorates, you've got a collective provision that covers it. So we, as analysts, shouldn't worry about when companies ultimately fall over. But unless I'm interpreting it incorrectly, Slide 22 shows $298 million for these bad full loans, these very evil full loans, but the collected provision write-back is all of $46 million. Pete, I'd just be interested, could we get some kind of confirmation that, that is the right way to read the chart? And is that the order of magnitude of the delta? When these things fall over, how much of it is the probability of default moving to 100 and how much is a change in the last given default assumption? And the second question, Brian, is that if we have a look at Westpac -- Westpac has shown tremendous leadership in basically repricing up housing products if and when needed be. But if we have a look at where we sit today, it would appear that the front book housing pricing has gone up. Basically, you're embedding a bigger package discounting there over the life of the book. I'd just be interested, do you think it has strategically played out the way you thought or, in fact, has it not played out quite as well as you would've thought?

Brian Charles Hartzer
MD, Group CEO & Director

Do you want to take the first one and I'll do the second?

Peter Francis King
Chief Financial Officer

Yes. Brian, I think on provisioning, just in terms of what we've disclosed over time, Pages 67 of the IDP, I'll call it the famous Phil Coffey chart because Phil created that. I think it really sets out that -- the provisioning level on the different parts of the portfolio and what happens when migration occurs. So I think we've been pretty transparent with how that works. Unfortunately, we've had some situations where we have had -- I've gotten into trouble and the loss looks like it'll be high and you end up with that situation happening. Unfortunately, you're not going to like this sentence but unfortunately, that is the accounting standard that we sit with today. It is a procyclical accounting standard that does see provisioning low in the good times and increase in the bad times. However, there's also a capital deduction that we have with APRA that reduces the flow-through to capital. So I think we've been pretty transparent in the provisioning through this and unfortunately, that's the way the process works at the moment.

Brian D. Johnson
CLSA Limited, Research Division

So this isn't unusual? This $46 million gain is not unusual?

Peter Francis King
Chief Financial Officer

I think for some customer -- like...

Andrew Bowden
Head of Investor Relations

Brian, can you just repeat that? Because that wouldn't have been clear.

Brian D. Johnson
CLSA Limited, Research Division

I just wanted to clarify, so this movement, $46 million write-back against the collective provision for those 4 names versus $298 million specific provisioning, you don't think that's particularly unusual? There's nothing to call out?

Peter Francis King
Chief Financial Officer

I would say that is unusual. Having customers deteriorate like that is unusual.

Brian D. Johnson
CLSA Limited, Research Division

And so what drove that delta? Was it -- it's part of it is the loss-given default but part of it's the...

Peter Francis King
Chief Financial Officer

I'm not going to get into the specific customer details, which is where I need to get into to answer that question.

Brian Charles Hartzer
MD, Group CEO & Director

Brian, on your second question, I guess what I'd say is things continue to play out more or less the way we thought. We have a lot of different levers. I remember, a couple of years ago, we were talking a lot about package discounts and how that would work through and it's -- I guess all I can say is that we manage our pricing in a pretty sophisticated way, and we're constantly looking at variations in product mix, in discounting, on -- in commissions, in different channels. And the result that you see in terms of share growth and margin outcome this half reflects the fact that we've continued to do that pretty effectively.

Andrew Bowden
Head of Investor Relations

We might take a call from the phones from Azib Khan, please.

Azib Khan
CIMB Research

A couple of questions. Firstly, on the credit card interchange fees. From my understanding there, the RBA risk-weighted cap of credit card interchange fee is unchanged at 50 basis points. So why does that result in the softness in your credit card interchange income? And the second question is just on asset quality. So just with the 4 names, I appreciate you can't give the specifics there, but can you please generally describe what types of exposures they are in terms of maybe industry and type of business?

Peter Francis King
Chief Financial Officer

Yes, well I think our Pillar 3 document's got some industry style information in it, so I'll let you have a look in that. On the cards interchange, you're right that the industry average is reset every 3 years, and that's what's happened. Because we've had a lot of growth in premium cards, we've ended up with an average that's a bit higher than the industry, and so that's been reset down for us. And that's...

Brian Charles Hartzer
MD, Group CEO & Director

The interchange rate has a mix of different rates within it, so the 50 basis points is a weighted average. And such that your portfolio is differently -- has a different mix, you're going to have a slightly different outcome at a bank level.

Azib Khan
CIMB Research

Is that just -- sorry, does that mean you were previously higher than the 50 bps weighted average cap?

Peter Francis King
Chief Financial Officer

Yes.

Azib Khan

CIMB Research

Right. But wasn't the limit previously 50? So how could you be above it?

Brian Charles Hartzer
MD, Group CEO & Director

So it was a weighted -- it wasn't a cap per se in that sense. It was a targeting of a weighted average based on the mix of different interchange rates. We have a high-quality portfolio with a lot of premium cards, and those cards attracted a higher interest rate.

Andrew Bowden
Head of Investor Relations

Victor?

Victor German
Macquarie Research

Victor German from Macquarie Bank. I was just hoping to follow up on a couple of issues that you raised. One is credit quality, obviously, quite important for the market. I guess, one of the things that would -- sort of would be great to get sort of a little bit more clarity on is the overlay that you talked about. So you -- Peter, you suggested that the overlay has increased and -- particularly for the mining exposures, and that's sort of on the back of the fact that you are expecting lower BDD charge next period. Just your thought process around continuing to increase overlays in an environment where you think that BDD charges should come down rather than go up? And also, any more color you can give us on your mining exposures, what sort of stress assumptions you've put on it? What sort of provisions you have? Any additional color you can provide us.

Peter Francis King
Chief Financial Officer

Yes, on the overlays, in aggregate, they're up modestly, I think it's around $5 million or $6 million. But within it, the composition changed quite a bit. So we had some industries improve, so we did an overlay. That was allocated to mining because of what we're seeing. So not really a big change overall, just more in the mining. On the mining itself, Page 65 of the IDP has got a good slide. And exposure is actually down $2 billion, so we've got $12 billion of exposure. The stress ratio was up a little bit over the half. Part of that was the reduction in TCE but also some small increase in the dollar value of stressed exposures. So I think it's a part of the portfolio we're watching, but it's remained pretty robust at this point.

Andrew Bowden
Head of Investor Relations

Scott? Sorry, Victor. Sorry...

Victor German
Macquarie Research

Just one more question on credit card interchange fees. There's further regulation coming through. What sort of impact are you expecting that to resolve? And also, some of your peers have started to address the rewards programs to get some offset on that. Is that something that you expect to see, potentially, some offset on those fees reduction that you've seen this half?

Brian Charles Hartzer
MD, Group CEO & Director

Well, we'll have to see how it plays out, but it's fair to say that interchange is an important source of revenue and it's an important element of the economics of products. And so if interchange is changing, then we have to think about the economics of those products.

Andrew Bowden

Head of Investor Relations

Okay. Scott?

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. A couple of questions. firstly, on the New Zealand margin, just the extent to which that's generated by the mix shift of variable assets' floating rates and, indeed, whether there's 2 or 3 more periods of this kind of averaging through the portfolio income?

Peter Francis King
Chief Financial Officer

The portfolio in New Zealand is about 80% fixed, 20% variable. The vast bulk of what's happened in New Zealand has been spread change, so I wouldn't call it mix between products. It's been the spread on both mortgages and business that's played through there.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And secondly, on the offshore lending, the reduction to effectively 0% LVR for offshore lenders. If you can just talk through whether if you're looking at the overall kind of growth yet, whether that means that -- what proportion of flow was it previously versus currently. Industry feedbacks suggest that you are more active in that space than others. And does that mean that you'll ultimately end up growing below system over the next 6, 12 months?

Brian Charles Hartzer
MD, Group CEO & Director

Well, in terms of a decision, generally, we've been looking at the risk settings in a number of areas, as we always do. And it is actually a relatively small percentage of the book and really quite a small percentage of flow, which you can comment on in a minute, Peter. The main driver for us there has been the fact that capital rules and security -- securitization-type issues in funding are changing. And so we're having to think more carefully about how we ration where we want to use balance sheet. And in that respect, our strategy is very much about long-term relationships. And as we thought it through, we found that it's increasingly difficult to argue you're building long-term relationships with people who don't live here and don't have visas to live here. And that was the primary thing that drove our decision.

Andrew Bowden
Head of Investor Relations

Brett? Oh, sorry.

Peter Francis King
Chief Financial Officer

On the flow point, credit criteria in this portfolio has been progressively tightened over the last 18 months, so it hasn't been growing that fast. It's about 3% of the portfolio, to give you a sense of the size of the portfolio. So I don't see it as a big issue for the growth in the book.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And just finally, in terms of this kind of stressed numbers that you run through the book in terms of potential loss given the commodity prices at ASX. Obviously, commodity prices have gone up, but there's been hedging support in place that's been shielding some exposures. So with these single names, obviously, to what extent do you think you could've taken provision earlier rather than waiting for a missed interest payment or a debt restructuring obligation specifically when you do stress those portfolios at those low levels of commodity values?

Peter Francis King
Chief Financial Officer

It's always a judgment. So you're in the world of judgment there. It's something that we always look at. Should we -- would we have taken it earlier? I don't think so. Actually, I think it's -- now is the right time to take it. We've had new information, we've got company plans and we understand what they're trying to do. So...

Brian Charles Hartzer
MD, Group CEO & Director

The other thing, I think, to reinforce is there are company-specific factors in a number of these situations. So it's not as simple as saying it's commodity prices leading to the outcome.

Andrew Bowden
Head of Investor Relations

Brett?

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Brett Le Mesurier from APP. A question on deposits. With the large increase you had in TDs, how does that relate to the improvement you had in funding costs? So your deposit -- your total deposit cost fell by about 3 points or the benefit to NIM was 3 points. But when you put that specifically against TDs, that's about a 15-point improvement in funding costs on TDs. How do you achieve that?

Peter Francis King
Chief Financial Officer

Yes. There's a bit of a transfer pricing in here, so the TDs, I think when you look at the yield on them, you're right, they probably haven't changed as much. But when you look at spread on them over the transfer pricing, the spreads improved a little bit because of what's happened both in the customer price and the hedging. So the waterfall view is probably the best view of that and it's equally split between the savings products and the term deposit products.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

so can you refresh my memory as to how you do the transfer pricing?

Peter Francis King
Chief Financial Officer

The equivalent swap rate for 3, 6 whatever months it is.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Right, but with some sort of margin attached to it, I presume?

Peter Francis King
Chief Financial Officer

No, that's it.

Brett Le Mesurier
Asia Pacific Prudential Securities Pty Ltd., Research Division

Just that flat level.

Peter Francis King
Chief Financial Officer

Yes.

Andrew Bowden
Head of Investor Relations
I can see there are a couple more calls in the phone, but I might call it a halt today. Thank you very much for coming this morning, and good morning.