Question and Answer

Hany Messieh
Former Investor Relations

We'll take your questions in a second just a few points. We'll follow the same process that we normally do. Follow -- raise your hand to indicate you got a question. We'll get a mic to you. If you can state your name and your organization, and please keep it to one question, if you don't mind, so we can get around to everyone. So over here, Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. A question on commentary around positive jaws. It's a nice little target to have, but I think you sounded out like no one's got any idea of what's going to happen going forward in forecasting revenues for the biggest challenge. And you can see in the second half how difficult that is. Do you need to start going to a much more definitive target on costs, whether it's flat cost, 2%? What really should you be looking for, for that cost line given the difficult environment going forward?

Cameron Anthony Clyne
Former Executive Director

Look, we've got to remain very vigilant on cost. One thing we're not going to do is short sell the business. And it's quite clear we need to replatform the businesses and write about things, and we'll continue to do that. Now if revenue is softer, then, yes, that's going to present some challenges. It might be even more technical in some short-term stuff. But we're very committed as a management team to go the longer term replatform. It's got to be done.

Now if you think that the economic conditions will be very subdued for a decade, then you might have a much different perspective on what you might do on the cost front. That's not our thesis. We think even in an environment of GDP growth in 3 to 4 plus inflation, 2 to 3 is still looking at credit growth perhaps coming back in the 6 to 7 range. So we're in this equation, but we know this is going to take a decade. So we're comfortable at the moment that we've got a strong focus on cost. We are going to remain committed to the investment platform because we think anything else and start to take the easy short-term routes just puts us back what we spent 3 years digging ourselves out.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. I don't want this to be interpreted as a question of whether or not you will take risk rates if the RBA goes next week. But in -- this is the first set of potentially decreasing cash rate environment that we've been in for the last couple of years. Previously, when you look at the impact on margins for decreasing cash rates, you look at it as some small pressure on deposits because of the low-rate deposits. But in the last 3 years, the banks have changed their funding mix. Quite considerably, you've got less short-term funding. You've got more long-term funding, and you've increased your tenor of funding. So could I get you to make some comments on if we do go into a decreasing cash flow environment, the more or less impact on margins from the fact that you're funding mix has changed?

Cameron Anthony Clyne
Former Executive Director

You're right that -- sorry, I can't say it. Why did you have to say falling rate? So in a falling rate environment then the free floats and things like this become less valuable, but they are smaller in the mix, because there's been a lot of -- I don't know if it's customer education or what, but there's a lot more turn to positive trend. And I say, [indiscernible] type contributions in the mix, so there will be some, I guess, drag from that but probably a higher proportion of the deposit base is going to be sensitive to the new rates, and it's going to get repriced at those new rates. So there will be a slight detrimental effect, but probably not what it has been historically, I'll say.

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Can I ask a question about the Business Bank margins? I'd like some more detail on why the banks are strong, specifically what's been the impact of lending versus funding. What's been the impact of the housing loans that are in that division? What's been the impact of the mix? And also you flagged competition as an issue that will affect the outlook. But I can remember 12 months ago, your flagging competition as a headwind for the margin in the Business Bank, and you've had a very good year. So could you give us some commentary on the outlook for the margin within that region?

Cameron Anthony Clyne
Former Executive Director

I'll get Joseph to answer, but competition does remain. I think what we did flag, I think even going back 2 years ago was that we did feel that one of the [indiscernible] our focus through that would be that we were the most divert business bank through the jaws, so the facts are irrefutable. And that's when you know the Business Bank to support you. We thought there would be some benefit to fly from that. So I think that's part of it. That helps to shed some light on some of the competition. But the competition is pretty intense, but we do see that relationship platform. We exhibited it particularly in '09 that it is coming back to help us. But, Joseph, do you want to address the margin relationship?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Well, indeed. The relationship and then platform, the reputation that we have as a Business Bank and the way that we conducted ourselves through 2009 to 2010 has translated into economic value as we were expecting that it would. That commitment to our franchise and the -- has really reduced the price sensitivity of competition in terms of our existing book, in terms of protecting our franchise. The other thing that the margin does reflect is the ongoing reassessment of risk in sector-by-sector. And of course, the environment today does represent some risk in some sectors, and we've had to reprice those sectors and clients to reflect the risk that -- Mark has talked to some of those factors. So it's really a combination of relationship strength, which we invest in over many years, consistent approach to the marketplace, and a strong discipline on pricing for risk has resulted in the margin that we've got today. I'm not going to forecast what that margin might look like the next 6 months or next year, but I can forecast that commitment to relationship banking into our customers is unwavering.

Richard E. Wiles
Morgan Stanley, Research Division

Just follow-up on that. I mean your answer basically talks about street franchise. But I'm wondering, can you provide some detail on the trend in your lending margins, the trend in your deposit margins? Have you had a real funding benefit in that division? Has the cost of deposit funding come down? Could you also talk about the impact of the housing portfolio that's included in that division? And finally, maybe a comment on whether you're getting better margins at the top end or the bottom end of Business Bank in such a big division?

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Yes, I'm happy to that. I mean our portfolio, of course, is heavily weighted towards SME lending assisting from a lot of institutionalized corporate. And that place tends to be stickier and more relationship sensitive -- more relationship strong versus the top end of time. On deposits, we have been very disciplined in our deposit forecast. We're obviously seeking to grow deposits but not at the trade-off of the economic deposit. So we haven't been chasing as aggressively the whole deposit market, and we've been careful in managing our margins in that respect. So I think those are the key combinations that have been a big focus for us. There's a strong bias towards SME. It certainly is a source of competitive advantage relative to other players in the marketplace. When you look at the information pack, you'll see that the mortgage book is approximately about 30% of the entire portfolio. So when you do the math on that then you'll see

-- you work at the underlying business margin is significantly higher than the 266 that's [indiscernible] the average NIM.

I'm very pleased with the way that we've been able to protect that. And I look to the customer satisfaction stats and the fact that we've been growing market share as evidence of our emphasis on and making sure that we're not seeking to maximize margin to short term but with longer-term consequences in terms of reputation and market share. But it plays back to the strength of the relationship model.

Unknown Analyst

[Indiscernible] from KBY. I have a question for you on the SCDOs. Towards the back of the foray, you typically put in a table, which you've done today, which shows the total asset value of the SCDOs against the fair value entitled asset value [ph] 1290 against the fair value of [ph] 991. And that 1290 comprises the 690 in relation to the 4 deals that now have protection in the other $600 million. Am I right in thinking that -- and also it shows that there are no provisions with respect to those specific provision. So am I right in thinking that the -- there's a $300 million gap in value between the 2 remaining ones and the balance sheet carrying value of them?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, I'm pretty sure that whole gap relates to the remaining instruments, which are quite long lived. They got their 7-year instruments, and I think they're somewhere around $0.50 in the dollar or something if you try to sell them. So they would -- there's $600 million, so that's about $300 million of mark.

Unknown Analyst

So the $600 million is what's on the balance sheet?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

The $600 million is where we still have risk. They're all still on our balance sheet because we haven't actually gotten rid of the instruments. We just traded out of the risk in them. But there's only 2 that are not effectively worth par, and they are the 2 that drive that difference.

Unknown Analyst

And the other 4 if the counterparties fall over, then you're effectively back on risk with the underlying.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, well, we've got a very, very solid counterparty.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi here. Just focusing on NexGen, if we could. If I look at your disclosures today on Pages 20 and 23 seems to suggest that your infrastructure investments spent over the last 3 years probably tallies around $1.4 billion of which the majority is NexGen related. Your capitalized expense balances are up 25% year-on-year although the amortization levels are down year-on-year. And reading the release, one sort of gleans a little bit of slippage in the foundation release whatever that may be of the core banking platform being employed now since calendar year 2011 to sort of FY '12 in the language. Can you talk, please, about when you can perhaps see customer loans and most particularly deposits migrated as perhaps the key to implementation risk on the system, but also customer benefits emerging? You seem to have spent about $1 billion so far. Are we halfway through in terms of spend end time on the project? And have some [indiscernible] amortization for this project, please.

Cameron Anthony Clyne
Former Executive Director

I think we -- in terms of cash and benefit, we actually have obviously a new bank actually built as a customer platform. And we are increasing the functionality on that platform. So at least that gives an insight to people as to the sort of functionality that's kind of [indiscernible] to the market.

We are very comfortable with progress on this. We've called out that, yes, it's a multi-year program. The other thing is we've taken a part of deliberate approach of actually spending that money or the initial components the money on the infrastructure lap. A little bit about that. But yes, we think you got to have a solid foundation, so we prioritize things like financial system, customer analytics, quality research agents, securitization platforms. Those sort of things that have a, I think, accretive. You got to do them at some point.

And so that does not suggest that the money we spent anywhere. I think we're very pleased with the progress. But, David, do you want to give your outlook on that?

David John Thorburn
Wave (No.1) Limited

Thanks, Cameron. Thanks, Craig. And Cameron mentioned that in the presentation. It is a multi-year, multi-level transformation. So there's a lot of below-the-ground transformation that we undertake that does have a very real customer benefit today plus the above-the-ground, which is typically functionality and the capability that customers see. So below the ground, we got a huge transformation program underway. And we're currently executing around our data center, so that's your mainframe or service and all of those. And as we're replacing those and reconfiguring those, that provides better system availability and capability as well as our system availability for our core channels like net, connected business banking, ATMs. Internet banking is the highest it's ever been as a direct result of the infrastructure transformation we have underway. Cameron mentioned in the slide the network transformation that we've completed now across our entire network. That has resulted in a reduction of our technology-related incidents in the retail network and the business banking centers by as much as 50%. So that things are going more system availability for our banker and for our customers. So we are seeing customer benefits already. But in terms of undertaking this transformation, it's a little like building a house. You can't put the roof on before you've actually put the foundations in place and built the walls. And that's the -- we we're spending a lot of money for it, so there is a bit of value in there, but in terms of what's outside the visible value that kind of likely is.

James Freeman
Deutsche Bank AG, Research Division

James Freeman from Deutsche Bank. Mark, I was just hoping, and I apologize for focusing on such short time frames, but I just want to actually get an idea as to what happened in the fourth quarter in terms of the margin because [indiscernible] it looks like the margin has fallen 8 basis points in the fourth quarter, which is quite a big drop given what you disclosed in the third quarter. I was just wondering, actually, what was driving that, if we can get a bit of an idea. Because it looks like the exit margin in the fourth quarter is substantially below the second half?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, look, I haven't -- I've been focused on the 1.5 years. I haven't dug into quarter-by quarter, so I will look at that for you. I suspect that there’s some change in the noise, some of the accounting noise, but also the mortgages would continue to chip away. So that there'll be some substantive factors as well as some cosmetic. And also the liquids only ran up in the last quarter, so you get that affect only. And over a shorter period of time, it will have a more dramatic effect. So why don't we just -- we'll do a quick break for you this afternoon and show it to you.

James Freeman
Deutsche Bank AG, Research Division

And just following up on that, is the exit margin then -- is that right, the exit margin is substantially below the average in the second half? I mean it looks like it's 4 or 5 basis points below. Is that the right way to look at it?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Look, I mean our feeling in the business is that the margin is basically healthy, apart from the effect of growing disproportionally in mortgages. So it's not like we've certainly got holes in the bottom of the boat or anything on that.

Unknown Executive

We'll take one from the phone.

Operator

Your next question comes from the line of Matthew Davison from Merrill Lynch.

Matthew Davison
BofA Merrill Lynch, Research Division

My question related to your Tier 1 generation. And in particular, the information on Slide 106. I guess on this we can say that the average risk weighting on corporate lending has come down significantly. And without that, I guess, you wouldn't have generated nearly as much Tier 1. So my question is about the reasons for the full year and whether you see that going forward continuing? And if not, does this affect your willingness to keep up the current level of our share growth that the revenue will win a lot of share?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, I mean this really goes -- this is sort of the unwinding of a legacy problem in the -- when we got accredited for Basel II, it had really a light rung. And if you remember, we got accredited probably 6 months behind others. But really, its capabilities we're way behind. And so we've been engaged and we've talked about it as RWA released -- capital release for a number of years now. And really just bringing our capabilities, our housekeeping, the way our models are configured and work, and so forth into line with competitors. And we still have not reached the same level of efficiency in that as competitors. So each year, we identify a number of areas of difference, and we go after them. And that's probably, over the last 3 or 4 years, released $90 billion plus of RWAs or something. So it's been quite a significant contribution, but it's simply housekeeping. And each year, we refresh the target. Now we'll run out at some stage, but it hasn't yet, and we'll be going after some more in future periods. So we don't count it as permanent and factored into our dividend payout policies or anything like that, but it is something that we do expect to contribute for a while yet.

Victor German
Nomura Securities Co. Ltd., Research Division

Victor German from Nomura, I was just -- if we look at the funding environment, it's clearly deteriorated in the last 6 months. And as availability shows up in the market, it's obviously at a much greater price. Can you just perhaps highlight how does that impact your strategy, particularly in the Personal Bank given that margins in that business are relatively low, and if you have to raise funding at much higher rates, what's your thought process in your ability in growing well ahead of system as you have done over the past year?

Cameron Anthony Clyne
Former Executive Director

Well, there's really 2 parts on that. The first part is what might be the short-term impact and whether we have the side appetite pricing for that. But much more important question to ask is we know where we're tracking to. We're tracking to 100% net standing for funding, and so you can't take a breather in the market. So our view is that we've got a well-executed funding plan. We got to get out there and execute that over the next 7 years to get us towards that target. And that meant to us as much more important. Now that might change our view depending on funding and the process of what we do with regard to the -- at the type we've got for mortgages. If business credit card turns back more quickly, obviously, that's something you want to -- there's moving parts as to what might happen in the market over the next year or 2. But for us, the much more important task is the fact that we got to have a committed program, which we've got to get us towards [indiscernible].

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

And product ROEs is still very attractive, so you wouldn't turn off product growth for that. And there's still -- the question is, well, what if the prices gone up too in the marketplace as well? But you're right. And we do -- given current market conditions, we would now predict that the average cost of funding would probably peak mid-2014. So we're going to be in rising average cost of funds in the next 3 years.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

It's Ben Koo from Goldman Sachs. Just a question on the business lending growth and just -- I'm looking at the half-on-half growth in business lending, with the change -- while looking at Slide 22, the change over the half was that you saw the corporate institutional Business Bank, which choked in the first half. It grew again in the second half. And that business has also slowed down on the flipside in terms of half-on-half and volume growth in this segment. So I just want to get a feel -- perhaps a question for Joseph, firstly, which areas segment that helps the economy actually taking on loans right now given concerns about the 2-state economy [ph]? And secondly just whether you're expecting growth to come more so from the institutional rather than the small business in the middle market, which is historically where the growth has come from?

I'm sorry. Just reconciling that as well with a big acceleration in your credit card forecast in the back of the pack, the economic forecast is quite a big acceleration in terms of what you're expecting for system growth to recover into 2012.

Joseph C. Healy
Australia and New Zealand Banking Group Limited

Well, on the question of system growth, we continue to hold the view there's a significant amount of pent-up investment that has to take place in the economy with businesses have to replace fixed assets in order to keep their business models operating. So I think that's a reality that will become evident when business confidence returns to the levels that we have been hoping would happen for some time now. But there'll be no sort of business confidence environment is like and has impacted by the [indiscernible] environment, et cetera, et cetera. The positive factor, in my mind, is that when you look at corporate balance sheet, I'm talking here about the top 500 to 600 corporates, we are a 34-, 35-year law in balance sheet leverage. And so there is a significant amount of balance sheet capacity for companies to come back to the debt market. And so quite apart from the CapEx, essential maintenance CapEx, we still believe there's quite a lot of pent-up, event-driven activity, M&A-type activity, which we're seeing some evidence of that now. And we think that will be a driver. So I think the main driver of credit mix in 12 months is the same things like infrastructure will largely be in the top 500 corporates with significant capacity to use balance sheet, to drive investment and to drive events when confidence returns.

We continue to see some growth in the SME space and again essential maintenance, but that will vary across sectors, reflecting -- some sectors are doing much tougher than others. Some sectors are well-placed to grow when the conditions return. So -- but largely if there is a summary answer, it would be much more in the top 500 segment that we see the lending activity really coming back.

Michael Wiblin
Macquarie Research

Mike Wiblin from Macquarie. Can you just talk a little bit about the collective provision movements just sort of the $332 million. I know there was a release of some $75 million flat overlay. But just by division, what you're seeing there, what's really driving, I suppose, your confidence that things are getting better?

Cameron Anthony Clyne
Former Executive Director

Well, we're not conscious -- I mean [indiscernible] which we called out but actually that held the group and actually reflects actions. So that's why there's been no conscious decision. I mean the reality is it's hard to go on in collective to specific on the models as we have updated our customer financials in particular, driven our credit rating score. And that drives us to a single provision [indiscernible]. So we're not making any conscious decisions. We're not making an economic overlay adjustments. I mean you been asked a question about too-spread economy, moving as a thin-spread economy. And a simplistic thing is to say mining good rates are bad. It's much more granular than that. And you've got, obviously, a whole range of companies there that actually are doing -- they're not at the booming end of the equation, but they're actually quite solid. And if you get -- as the economic conditions improve or there's more stability, it's reflected in the credit scores in those models.

If you go to Ben's question about the confidence and what might happen in business demand, what we do observe, and we spent an enormous amount of time talking to our customers, is the pent-up demand is not fictional. But every time it looks like it's going to merge, you have an event which forces them to stop. And we didn't see I think just probably between the period of sort of March to June, actually quite a significant uptick in confidence. And this is [indiscernible] on the ground we're talking to. And then you start at the U.S. debt ceiling and we went from there. So when you get a sustained period of international calm, you do actually find that, that comes too. But in many cases, I've been sitting on non-fixed asset replacement for some time 3 to 4 years.

We're not talking about expansionary investment, but just getting to the point of actually replacing cost upside. If you get that, you'd do it. And so when you take that 10 spread view and that's kind of was reflected in the collectives. Now there is certainly some stressed points at the end of the lines to the specifics. And then you've got just the general improving health from what was sort of quite scoring with a much more dire outlook sign in the '09 and early part of our '10 score. But we're not making -- we've made no conscious or any change to our economic [indiscernible] at all.

TS Lim
Southern Cross Equities

It's TS from Bell Porter. You lost 175 advisers in the last 6 months. Do you have plans to replenish them, maybe through M&A? And what is the optimal number of advisers to run a business like this?

Cameron Anthony Clyne
Former Executive Director

Well, the ones we lost, I mean by and large, by our people leaving the industry has been quite a high degree of exits from the industry over the past couple of years. But our new adviser growth has actually been stronger than it's ever been. The other track that level of advisers. We certainly don't have any M&A in that space planned and we don't need to. That sort of level of advisers is enough for [indiscernible] another prices. And we can see that over 300 that have come through the door. Steve, do you want to...

Unknown Executive

I think that's right, Cameron. There's a lot of regulation uncertainty on some of the older advisers taking a chance to move on. But the net adviser growth for us in the last 12 months has been unprecedented and very strong. And we think it should continue. We're well placed to help advisers to make the transition to the new environment, which is why they're joining us. In the next year or 2, that will continue, I think. In terms of the optimal adviser number, as long as they're high-quality and they're productive, then we'll have as many as we can get, and it's a competitive to do that. But our organic activities have been really successful so that shows that you can broad around the right offer and get growth, which is what we're after.

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson CLSA. My apologies. I've got another question for Mark. Mark, if we have a look at Slide 17 and we have to look at the liquid asset holdings, can I just confirm that the $55 billion at the bottom is the level 1 liquidity for the LCR. Where will the LCR be right now? How much does that imply the RBA facility would be and what's the expectation of the pricing on it which your peers have been hinting is 25 to 40 basis points?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

All right. And I'll give Eric a heads up to comment on this. But we're in no way -- no decent way through our transition to LCR. I mean it takes time to try and accumulate Australian sovereign debt, get your bank paper and corporate paper into proportion and so forth. So that's going to be a multi-year journey. And so I don't think we know and I've seen quite wide estimates amongst the peers, the level and the cost ultimately of the RBA facility. So I don't think anybody really knows. I think the way we regard it is that we want to show APRA that we are doing all the things we can reasonably do to get ourselves as close to compliance on our own account as we can. And I think if they think we've done a reasonable job then whatever the gap is, the gap will be plugged. But I don't know. Eric, do you want to add some specifics?

Eric Williamson

Yes, I guess on the LCR, a simple answer to the question, really. We haven't disclosed that yet. And as Mark said, we are in a transition phase. We will know more about the final rules in due course. After release the draft liquidity standards, and we expect that stuff mid to late November. And I would also say that this slide is in relation to the liquid assets for the whole group, just not limited to that's $55 billion of liquids. It's just isn't the level one Australian liquids [indiscernible] bank liquidity in there as well. So that would be cash of the Bank of England, gold, et cetera as well.

Unknown Analyst

I can keep on asking it. It's just the Bank of Queensland might give you a feeling the Bank of Queensland has said it's like mid-80s.

Cameron Anthony Clyne
Former Executive Director

What are you -- what was that?

Unknown Analyst

I'm just saying the Bank of Queensland have been the indicator. I think this is roughly in the mid-80s, for example..

Cameron Anthony Clyne
Former Executive Director

What's in the mid-80s?

Unknown Analyst

The LCR.

Cameron Anthony Clyne
Former Executive Director

Well, it's not something -- it's not market ready.

Unknown Executive
Looks like that's it for questions. So thank you very much for coming in.