Question and Answer

Melanie Kirk

We'll take our first question from Jon Mott.

Jonathan Mott
UBS Investment Bank, Research Division

Ian, you talked a lot to start about the 10-year strategy and how the performance of the franchise is doing so well. But when you look at the mortgage sales, you can see that broker sales, and this is on Slide 97, broker sales are now up to 49% of all sales. Now if you go back in time to the same slide was in there back in 2012, that was at 31%. So you can actually see that you're becoming more and more aligned to the broker. Now if you actually multiply that by the flow of new business, you can see that the proprietary network's sales and mortgages have actually been flat for now 7 consecutive half years. You've had no growth in proprietary sales, while you've had one of the biggest housing booms of all time going on in Sydney and in Melbourne in particular. So what is going on with retail sales and despite all the demographics that you talk about, the customers you have in that baby boom -- or not baby boom, in the young demographic, why can't you sell through the proprietary network?

Ian Mark Narev
Former Executive

Well, go back 8 years and go back to the comments that we made at the time that we made the investment in Aussie home loans, and what we said at the time is as good as we will ever get in investing in the proprietary network, and good as we will ever get in continuing to build on the historic strength of the Commonwealth Bank, which is home loans, we said way back then, 8 years ago, that we consider the broker market was going to be a critical channel where customers were going to choose to deal with their banks, that no matter how well we did, that would be effected, that would continue and we have seen it continue. Now we say 2 things. Number one is we see the broker channel as an ongoing channel where customers are going to want to do business. The proposition of the broker channel in terms of its neutrality, its separation from the banks, is pretty clear to customers. We've also said that we're going to invest in making sure that as many of our customers as possibly can are going to want to do proprietary business with us. As good as we get, we'll never be so good that we're going to reshape a market. I think if you look at the Commonwealth Bank's relative performance relative to others in the market, we're pretty happy with where we've got to.

Jonathan Mott
UBS Investment Bank, Research Division

So having said that, your share of total sales has gone from over 20% -- this is in the proprietary network -- to below 15%, so it's been a pretty dramatic fall. Now, all the other players have seen absolute growth. And I'm talking about the other majors and regional banks, they've seen growth through their proprietary network. So is there something that you can do? And I'm not talking about, we all know the trend, that brokers are now at 50%, but what can you do to actually grow the -- not the broker side, but actually the proprietary side? Is there things you can do to get that going? Because we know that it's a less profitable channel through the broker than it is through the proprietary network.

Ian Mark Narev
Former Executive

Well, as I said before, I mean, one of the key priorities for us from the strategy is, a, have a good interface with the brokers, because people will want to do business. And b, continue to invest in the proprietary channel to make it a place where as many customers as possible want to do business with us. Our view is as we continue to make investments in the quality, particularly, of the digital channels, continue to invest in the frontline and continue to work on the strategy where customers are getting a much more seamless interface between deposit products, home lending products, their super, their insurance and other wealth management needs, that, that is going to create a superior proposition. And that's what we're working towards. But I would say, if I'm sitting here 10 years on, with a market share above 25% still and the margin where it's at, I would have taken it any day of the week.

Melanie Kirk

We'll take the next question from Victor.

Victor German
Macquarie Research

Ian, just down here. Two questions from me. The first one on divisional performance. If we look at second half as opposed to year-on-year comparisons and even adjusting for a number of their differences, every division, with the exception of Retail, that benefit from repricing, has gone backwards. Just interested in your thoughts, whether you think that that's appropriate for the current environment and what steps do you think you can take to improve that going forward? And the second question, if I look and you talked about ROEs on Slide 66, you provide 5-year ROE performance, acknowledging the fact that you still do have sector-leading ROEs, you have converged to peers and ROE has obviously declined. Historically, banks have taken a view that because of the relatively strong position in domestic markets, you were able to largely maintain ROEs, even in an environment of high capital. What do you think has changed? Do you think that now that we're operating in lower interest rate, low growth environment, it's going to be a lot more difficult for banks to maintain that level of return going forward?

Ian Mark Narev
Former Executive

Well, let me start with the second question, I'll make a quick comment on half-on-half and turn on to David, who might want to give a bit more detail. But I'll start with what's changed, we have to look at Page 58, and I say in June 2007, we were holding $9 billion of common equity Tier 1 capital and we're sitting here today with $42 billion, because of events that we all understand. So the first thing we look at is the denominator and the denominator, under any analysis, has increased dramatically. And what we have said all along is that in this sort of environment, it is unlikely that we are going to be able to capture returns on the additional capital that mirror the returns that we had on the legacy capital, and that has so far proved out. Now there are aspects of the performance at the moment which you will understand very much leverage the environment and people keep forgetting low interest rate environments are not great for banks. I don't think many of us believe we'll be in a higher interest rate environment soon, but there are those sorts of factors, and our determination is to keep focused on the business and keep looking at what we can do to keep the relative ROE as strong as it can be, recognizing that there are some aspects beyond our control. On the half-on-half, and I'll get David -- you might want to point out a couple of the specifics, but again, and we were chatting with some of our people on this earlier in the week, if you speak to most people in most businesses at the Commonwealth Bank, they will say to you the second half felt a bit harder than the first half. We are products of the economic environment in which we compete. And on all sorts of dimensions, whether it's macroeconomic or competitive, the second half felt a little bit tougher than the first half. Now you can see that in terms of the outlook, we have suggested it's roughly more of the same and inevitably in these environments, some businesses might get a bit better, some might get a bit worse. But we sort of see the environment from the last year being pretty good indicator of the kind of environment we're going to get over the next 12 months. Do you want to add anything to the half-on-half?

David Paul Craig

Not really. I mean, don't forget there are fewer working days in second half, so our second half is traditionally flatter than the first half, so that's clearly an ingredient. In this particular case, you've also got to look at the timing of rate movements, which again, favored the first half over the second. From our point of view, there's no really significant difference other than we're in a lower growth, low interest rate environment. And so overall, returns and profitability for rural banks will be coming down. On the ROE thing, I think you've got to look at -- again, we've got very large licks of capital being raised at different times by different banks and banks reporting at different times. I think as you see that flow through and as the banks adjust to the higher levels of capital, things will stabilize again, and I'd be confident that CBA will still have a materially higher ROE than the other banks.

Melanie Kirk

We'll take the next question from Jarrod.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Perhaps a question for you, David. Other banking income, and particularly, fee income was pretty weak, being flat. Could you provide a bit more detail on the drivers of that flat result? And then looking forward, is there ability for banks to actually grow fee income going forward? And especially in a low interest rate environment, where margins do get pushed, what -- is there ability for you to actually use fees to actually pay for the service that you provide versus the margins that are getting squeezed?

David Paul Craig

Look, I think that -- I mean, clearly, there's been a long-term trend of fee income in particular coming down -- while not being as great a proportion of income for certain the Retail Bank as before. And obviously, there's been class actions and so on about fee income, which I think have now been clarified a bit. That said, and again, in our particular case with Institutional Banking income down, us doing a little bit less in that space, that is a business that traditionally has a much higher mix of fees to interest income and as that's eased back, then that's changed the mix of our overall income. So I've always said when we talked about net interest margin for example, that it's important, really, to look at total banking income rather than getting too fixated on one versus the other, and I think that's still the best indicator.

Jarrod Martin
Crédit Suisse AG, Research Division

And the ability to -- in a low interest rate environment where margins do get squeezed, to appropriately charge a fee for your service that can't be done through margins and whether that is an opportunity for banks?

Ian Mark Narev
Former Executive

Well, clearly, one of the key areas that show our intent in this regard is the importance of the Wealth Management business and the link between people's basic financial and banking needs of deposits and loans and their insurance needs, their super needs, their investment needs. Now I know and expect that in these sorts of environments, with these sorts of results, the normal debates will occur about why are we in Wealth Management. But the exact reason we are is because the confluence of those needs for the customers, a, is good for them, which is where it all starts. And b, it creates opportunities for us to keep earning income, which is separate from interest rate environments and the sorts of trends you're talking about.

Melanie Kirk

We'll take the next question from Craig Williams.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. CBA as the largest retail bank has been the biggest beneficiary of the industry's repricing of mortgages in recent years. And some of the benefits of this area seem to be running out if we look at your latest results, home loan net interest income down 3% half-on-half, volume growth by contrast, up 4% half-on-half. And we know that risk-weighted assets have lifted in July on that book. So why as the largest bank have you upped the ante in mortgage volumes in the fourth quarter, with pricing seemingly being a key driver of this time when political oversight of repricing is making the task of continuing to do so and supporting margins seemingly more challenging?

Ian Mark Narev
Former Executive

Because the critical thing for us is do business in a consistent way over long periods of time. And we've always got to be prepared to adjust to externalities. I mean, every business is going to. But if -- again, if you look back at the history of these discussions, these exact forums we've had with you folks 6 months in, 6 months out, every 6 months is why have you dropped share and the next 6 months is why have you gained share? And they are fair questions and the answer is being consistent, again, for years, which is we look at the volume-margin balance, we obviously want to keep a decent market share. We also want to keep a decent margin. Sometimes that means we're going to grow a bit more volume and sometimes we're going to grow a bit more margin. But what's absolutely critical for us is to listen closely to our customers, to watch the market carefully. But the moment we start managing the business because of particular other aspects of the environment for the short term, we're not doing our job.

Melanie Kirk

We'll take the next question from Andrew Lyons.

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Andrew Lyons from Goldman Sachs. Just a question on the IB&M division, for the bit -- just particularly the half-on-half performance, where you've seen the 10 basis point reduction in the return on assets, despite the bad debt charge actually being down about 20% half-on-half. Can you -- I guess, recognize that low rates is obviously a big contributor to that performance, but it is a part of the business that you are investing in. Can you maybe just do 2 things. Firstly, was there any particular issues impacting the performance in the second half that we should be aware of? And then secondly, what do you think you can do outside of the environment to actually improve the returns within that business?

Ian Mark Narev
Former Executive

The ROA, as you correctly said, and you can see the PA is down about 10 basis points, for a couple of reasons, including very esoteric reasons like pooling of the cash management facilities, et cetera, it's not a great measure, but what I'm about to say applies anyway. There are really a couple of different things going on. Number one is we are at or near the end of the above-average cost growth we need in that business just to get it at what we consider to be the right minimum scale for the business. And that's something we've talked about for a little while and we're at the point now where I would expect the ongoing expense growth of that business to be much more in line with the expense growth for the group because it's at scale. But you can see it's been a bit ongoing, and that has some pressure on returns. Number two, despite the fact that through the cycle we're in a pretty good place in loan impairment. This was a period where loan impairment went up. And those of you who looked at the Pillar 3 for the third quarter will see particularly in the third quarter, loan impairment spiked a bit, and it was back down. And this is because in these sorts of environments, a couple of names will always disproportionally affect the number. And third, as we've said before, it is a very competitive environment from the point of view of margins. In terms of what -- looking forward, what we very much base the strategy on is that the success is not growth. The success is deep client relationships, which do involve using the balance sheet, but involve using the balance sheet and then broaden out into different needs, including Transaction Banking, including our Markets businesses, which overall, create profitable client relationships. I have seen myself, as I've sat down with Kelly, a client-by-client look at profitability in the business. We're absolutely satisfied that if we're doing the right things, we are going to keep earning good returns. Not the same returns that we might add in other parts of the businesses, but good returns for shareholders, if we keep the right disciplines in the business. But we've also got to bear in mind that with all clients, and particularly institutional clients, saying, "Margins are a bit tough, sorry, we won't deal with you today." And if they get a bit better in 2 years, saying, "Hi, we're back," is not a way to run the business.

Melanie Kirk

We'll take the next question from Richard.

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. And I've got 2 questions. Firstly on the cost, Slide 35 shows that costs were up about 4.5% year-on-year. But 12 months ago, you included a slide that showed that there are $150 million of nonrecurring wealth remediation costs in 2015. So it looks like the cost growth for the year was more like 6%. In the second half, it was flat. Does this reflect a sort of change in your strategy on costs, you're moving from a fairly high cost growth profile in recent years to a more disciplined approach to cost in the second half? And second question just relates to institutional. I acknowledge that your Markets income was up in the second half, but revenue was still down. For the full year, your profit was down 10%, your assets were up 10%. This business is generating $1.1 billion of profit on $180 billion of assets. You don't disclose your RWA, but it seems like it is a single-digit ROA business. So just following on from the previous question, can you confirm -- can you give us some idea of the ROA in this business?

Ian Mark Narev
Former Executive

Well, let me take the second one and then I'll say a quick word about expenses and get David to add as well. Again -- and this is rightly a topic of ongoing discussion between us and you folks, and us and investors, on Institutional Banking & Markets. We wouldn't be in the business if we felt that over the medium to long term this wasn't a good place to deploy the shareholders' capital. And whilst some aspects of what we're seeing at the moment are clearly here for a while, so we say cyclical, but someone's cyclical is someone else's structural, it just depends on for how long. But we look at the returns of the right client relationships and we can see that they provide returns to the Commonwealth Bank shareholders that are above the cost of capital. Now there are a couple of factors that I spoke to before in terms of the previous question, which were one of the things that we have said at board level at the Commonwealth Bank, is that if we're going to be in this business, which we want to be, we want to make sure that the investments we are placing in it mean it's at effectively the minimum scale it needs to be compete well. And that has meant that expense growth in that business has been higher, probably for the last 2 to 3 years than it would be at run rate, and I feel we're much closer to the run rate now. Now separate from that everyone's got their own views on what the long run returns in that business would be. My own view would be if you are only hoping to use your balance sheet, you are going to have a business which erodes value. If you're prepared to build deep client relationships, you can have returns that are above the cost of capital. You've got to bear in mind, and again, a number of you have correctly pointed this out, that if you're doing a little bit more, you're going to have a bit more volatility because of loan impairment, and we're obviously very conscious of that, but again, I think you can see in this period, that's been managed pretty well. On costs, I'll get David to talk about the nonrecurring, but I would say not really a different level of -- a different approach to costs, but clearly, to say what I said before, if I break this down, I feel management's day-to-day management of BAU costs is actually very good. I think the focus on productivity genuinely at the process level is very good. Where we've got more work to do is on 2 fronts. Number one is that there's a lot of change going on in this organization. It's here to stay. It really is a structural trend and none of us believe that the cost of change here is at the level it needs to be for us to be as competitive as we can against new competitors for the long term. And I would hope that you will see, as time goes on, to your point about the last half, we're going to get better and better at that. And secondly, we remain in an environment, and this will be a good segue to what David will say about the $150 million from last time, where we keep getting extra licks of regulatory costs, whether it's remediation or whether it's anti-money laundering, or whether it's different things in cyber security or whatever it is. Last time we said what came across as a bit of a glib comment that these are nonrecurring, but next time they might be non-nonrecurring costs, and that is actually the way it is. But you might want to add to that.

David Paul Craig

Yes, before I get to nonrecurrence, I want to add one further point on cost management. And I think it is a distinction between us and some of our peers, that is we don't tend to -- we're trying to run the business in the most efficient way possible, but within the constraints of meeting all of the needs we possibly can of our customers. And so the focus is on growing revenue and then making sure we manage cost to below the rate that revenue grows. This is a good example of that this year, as we've had for quite a number of years, running of positive jaws. So that's the way we think about it in aggregate. Now last year, the waterfall chart that you see this year on Page 35, is obviously repeats each year. And the aim of the waterfall is to talk to you about material changes between years. And what I called out last year was that there had been a substantial uptick in compliance and regulatory costs, $151 million I think was the number, but that wasn't necessarily the end of it. In other words, unfortunately, as Ian has said, this is life. In fact, the -- so when we looked at constructing the waterfall diagram for this year, we looked at well, what's changed from last year. And unfortunately, this wasn't one of the things that had changed. Actually, the relevant things were $156 million this year, so there was a $5 million increase this year in that category, which I didn't bother to put onto the waterfall chart, being a relatively immaterial amount. But let's hope next year we don't -- I can report to you a fall in that category and it will appear as a nice chunk on the diagram. But unfortunately, we're not there yet.

Ian Mark Narev
Former Executive

There will be one day when we're here saying Basel's finished and we've got no more one-offs, and that will be a great day.

Melanie Kirk

We'll take the next question from Scott.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. Just further to Victor's question, but putting some more specifics around it. So the question I originally asked was way back in kind of 2012, '13, when Westpac had their kind of then-famous line in the sand around their returns and you were comfortable with maintaining your relative gap as opposed to an absolute level. Just putting some numbers around that. Back at that time, your return on tangible equity was 25.5%. Your peers was 19%, so that's a 6.5% premium. As we look in the second half, you're actually down at 19%, and your peers have only receded to 16.5%. So over that period, your premium of 6.5% has gone down to 2.5%. Very big erosion in a very short period of time and you've still got another $2 billion of wealth de-gearing on top to go. Has that premium eroded at a faster rate than what you expected back then and what are you doing to ensure it doesn't convert to peers in the future?

Ian Mark Narev
Former Executive

Look, we started off return on equity, now you're talking about return on tangible equity. What we have said, again consistently for years, is we're going to give you 300 pages of disclosure and you can decide based on that what you think the trajectory of the ROE is of the Commonwealth Bank relative to its peers. What we again say consistently is that this is a measure which is really important for us to keep measuring in the long term. We're comfortable with a long-term trajectory. But we realize as a board and as a management team that in these sorts of environments, ROE just doesn't look after itself. And so the focus on the specific capital in each of the businesses and the return on it is sharper probably than it was 5 or 6 years ago. It needs to be. But I'll just reiterate, the key measure by which we will assess ourselves is the impact of the decisions we're making today on the profits over the next 3 to 5 years. And what you're not going to see us do is take decisions which are going to spike the ROE for the short term, because some of the things you need to do that are to scale down businesses and annoy customers or to stop investment and those are not the sorts of things we think we should be doing.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And secondly, just wanted to check on the RWA relief. Slide 114, there was a big embedded gain, but the little blue piece of the chart there around where you're actually deploying the capital for in the first place also fell. So I just wanted to check whether that's just an impact of lower rates or whether you have actually shortened the duration? Obviously, with the flat yield curve for longer, the benefits of investing further out are less.

Ian Mark Narev
Former Executive

No, I mean, the approach to durations remain the same for the long term. In these sorts of environments, within the small limits the treasury has in terms of the lean on the balance sheet, that moves slightly differently in different interest rate environments, but the basic strategic approach to the DOE is exactly the same as it's been.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

All right. And just thirdly on Slide 99, we've got the home loan arrears by vintage on the bottom right-hand side. You can see consistently between the 2010 vintage and the 2013 vintage, the arrears continues to increase beyond that typical kind of 36 months to 42 months peak that coincides with the significant growth in the low deposit premium product for your high LVR, where you effectively self-insure, is higher house prices effectively mean the you're not going to take losses on that at some point? Or are you comfortable with the type of risk in that book?

Ian Mark Narev
Former Executive

No, the low deposit premium, again, it was introduced at a time, and most people would be aware, is the parts of the home lending book where we don't reinsure but we effectively take the risk ourselves. This trend, which we've had for quite some period of time, where the overall performance of that book is at or above the average of the book remains and the different functions in arrears here have typically been where you can see different economic dynamics, particularly in Western Australia and Queensland, which have driven the different performances of the vintages.

Melanie Kirk

We'll take our next question from Andrew Triggs.

Andrew Triggs
Deutsche Bank AG, Research Division

Just a question on the NIM performance in corporate in the second half, sort of digging into the disclosure between IB&M and the business and private bank. It appeared like the margin decline in the institutional [ph] bank, it eased somewhat in the second half. And if anything, did the margin pressure in the business bank had stepped up somewhat? Is that a fair conclusion to make? And if you could sort of discuss a couple of drivers there? And then just a second question around Markets income in IB&M. Was there much of a benefit from Brexit volatility on FX markets that came through in that quarter?

Ian Mark Narev
Former Executive

Look, generally, to take the second question, obviously, in terms of the work we do managing risk for our clients, events of volatility do tend to provide environments where markets businesses can do well. There was a little bit more activity around Brexit, but I wouldn't say it was a material contributor to this result. On the different margins, no, we don't break them down. We don't break them down for competitive reasons. What I can say is that yes, there is a lot of debate about the impact of margins in institutional bank because of global banks. Actually, if you look at some of the historic measures about alternative sources of funding for institutional banking clients, you would probably argue in the last 3 to 6 months, that has got a notch better in terms of the competitive environment. Business banking, as Adam and his team will tell you, is a very, very competitive market. Demand's not bad. I mean, you can see, to my point earlier, that there is demand for business lending, but all the banks have the capital to do it, want to do it for the right counterparties. And typically, in these environments where you have economic volatility but still some demand, there's greater competition for the high-quality counterparties and that translates into higher margin pressure. And you've seen a bit of that in this year. I expect that will continue for a little while.

David Paul Craig

Yes, if you're trying to compare the first half and the second half on the bottom half of Page 43, if that's what you're doing, then don't forget Institutional Banking shrank a bit in the second half and business and private bank grew, and so the relative difference in margins between those will have led to a mix change between the 2. So I don't think there's any material change relatively between those businesses. They're both very competitive businesses at the moment.

Melanie Kirk

We're just going to quickly switch to the phones. So we'll take a question from Matthew Wilson.

Unknown Analyst

Question [indiscernible].

Ian Mark Narev
Former Executive

Matt, we can't hear you, mate. I don't know whether it's the phone line or the speaker, whatever it is, but we're only hearing every third syllable.

Unknown Analyst

Okay, is that any better?

Ian Mark Narev
Former Executive

That's good.

Unknown Analyst

Okay. So Retail Bank net interest income, 130% of the half-and-half growth came from the retail performance margin, with volumes [indiscernible] and the cash rate is falling. And does that represent its [indiscernible] interest income both in the half. It appears that you stopped paying interest completely on $17.2 billion of deposits. Is that the [indiscernible] same [indiscernible] customers? And how does that reconcile with your focus on customers and balancing the effects [indiscernible] given that [indiscernible] was priced as much as what would be a rate rise last week or so. And then I've got a second question.

Ian Mark Narev
Former Executive

On that specific deposit point, I'll get Matt to answer the question. We think we heard most of it, but he can answer what we think we've heard and you can let us know if you want us to follow up.

Matthew Comyn
CEO, MD & Executive Director

Yes, I'll take my best shot at that, Matt. So I think there's a couple of things, I think in the profit announcement, you'll see there's a movement from interest-bearing to non-interest-bearing. It's actually in the transaction account balances that we're paying 1 basis point and they're paying 0 basis points. I think that's not the driver of the margin differential that you're looking at overall. So we saw an improvement in terms of the deposit funding cost that we get, which is a function of both the basis risk premium, the inverse of that is we're getting that charge on the asset side, we see that benefit. And as we've done in previous periods, we also look to optimize our overall portfolio of deposits through the period by focusing on the right composition between both savings and investments and continuing to grow above market in transaction accounts which allow us to expand the margin of the portfolio level.

Unknown Analyst

Okay. And then secondly, with David joining the Lendlease board effective 1st of March 2016, can you give shareholders some clarity on CFO succession plan, given the demands and responsibilities of now being accountable to 2 sets of shareholders in what are both very large and complex businesses confronting its challenging [indiscernible]?

Ian Mark Narev
Former Executive

Well, what I can say is that we're blessed with a CEO who's been with the bank since 2006 and done a stellar job. As David and I talked about his ongoing development plans, one of the things that I form the view, together with the board, together with David was, given how long and well he's been doing this job, he can do it equally effectively with the capacity to contribute in a governance factor, very different from the management factor, in another organization. And I suspect that they're already benefiting from it.

Unknown Analyst

Okay. But he's effectively part-time now?

David Paul Craig

I wish.

Ian Mark Narev
Former Executive

Yes, I wouldn't describe any executives as part-time. And if I were to, he certainly wouldn't be one of them.

Melanie Kirk

On the line is Brian Johnson.

Brian D. Johnson
CLSA Limited, Research Division

I'm tempted to ask, is CommBank clawing back the Lendlease fees, given that David is still a full-time employee? But that being said, I have 2 questions. The first one is you've gone to a lot of trouble today to say that you're unquestionably strong. Now is that your view that you're unquestionably strong or have you formed that view after speaking to APRA, who as far as I know, is still unsure as to what unquestionably strong means?

Ian Mark Narev
Former Executive

Well, Brian, you've been around for long enough to know none of us will ever purport to speak for APRA. But our point is if you look at any aspect of, both on an absolute and a globally relative basis, what we're really saying is if this is not unquestionably strong, it's hard for us to understand what would be. I can only answer this with a bit of a negative, which is we've been given no indication this is not unquestionably strong, but clearly, there's still a little bit of work to do, both domestically and internationally on this, but we feel like we're in a pretty sustainable position.

David Paul Craig

Yes, it's really important to understand and to listen to the vibe, too, of what's happening globally, where clearly, as part of what the Basel Committee is doing now they've indicated that they're very keen to keep capital levels roughly where they are. There may then be adjustments between banks. I think we'll see some shuffling, possibly, between countries and between banks, but let's not forget that Australia is at the very conservative end of any risk-weighting regime around the world.

Melanie Kirk

We'll move back to the room now with Andrew Triggs.

Brett Le Mesurier

Brett Le Mesurier from Velocity Trade. Just going back to the institutional business, you said that -- I think you said that you were going to continue to invest in that business as long as it beat your cost of capital, which does beg the question, what do you think your cost of capital is?

Ian Mark Narev
Former Executive

We've had this debate before, I know. We don't talk publicly about what our cost of capital would be, but we're confident the business would -- you would see that it was above our cost of capital on a number I think you would be comfortable with.

Brett Le Mesurier

A single-digit number, I gather you're referring to.

Ian Mark Narev
Former Executive

I'm not going to make any further comment on that.

Brett Le Mesurier

Looks like single digit to me. The benefit of free funds in the margin increased significantly from the first half to the second half, obviously, you had a capital raising which would have been a reason for it. You also had that change in transaction deposits classification. Was there anything else that happened?

Ian Mark Narev
Former Executive

Pretty much it.

David Paul Craig

No, that's it. And let's not get overly excited about that 1 basis point that we made when we shifted from interest-bearing to noninterest-bearing on transaction accounts. But yes, those are the 2 factors.

Brett Le Mesurier

The change in the half was 6?

David Paul Craig

Sorry?

Brett Le Mesurier

The change in the half was 6 for the increase in benefit from free funds was 1 basis point from 2015 to '16?

David Paul Craig

Yes, 1 basis point. Yes, exactly.

Brett Le Mesurier

Yes, yes, but it was 6 in the half.

David Paul Craig

Sorry?

Brett Le Mesurier

It was 6 -- it was an additional 6 basis points in the half.

Ian Mark Narev
Former Executive

Yes, but we're saying the 2 things you've outlined are the 2 big drivers.

Melanie Kirk

Next question from David Ellis.

David Ellis
Morningstar Inc., Research Division

David Ellis here from Morningstar. I've got a question on the dividend payout ratio. Slide 47, of course, sets the historical payouts and dividends clearly. And obviously, for the 2016 financial year, the payout's gone up from 75.1% to 76.5% and with the long-term target of 70% to 80%, in what circumstances do you see the current payout ratio declining more towards the lower end of the 70% to 80% target range?

Ian Mark Narev
Former Executive

Well, it's important -- we say a couple of things and it's really important that we reaffirm this every time. Number one is that dividends are not annuities and the board makes a decision each time around looking forward, but also in the environment they can see at the moment about the appropriate level, and that even though you can see on Page 47, the numbers have coalesced around a pretty tight payout ratio over recent years, we're prepared to use the range or even to go outside the range if it's the right thing to do. As we sit as a board and think about the dividend in any period, we're looking at the combination of our outlook for risk-weighted asset growth, our outlook on credit quality and our assessment to the discussions we had a bit earlier about where the world of regulation's going. And if we can, the #1 thing we're going to do is keep the bank safe and keep the bank able to support customers for the long term. That's always the #1 priority. Behind there, the second thing we try and do is give our investors some degree of consistency, and we generally achieved -- been able to achieve that and that will continue to be the approach that guides the board as we look at it. So the circumstance under which it would go down are probably likely that on 1 of those 3 factors that I've talked about, we feel less sure about the way the world's at or is going to be, and commensurately want to keep back a bit more of the profit to bolster the bank.

Melanie Kirk

We'll take the next question from the phones. We'll have David Spotswood.

David Spotswood
Shaw and Partners Limited, Research Division

Yes, [indiscernible] optimization of the capital. I mean, I know it's not easy, but I'd appreciate any sort of comment you'd make in terms of the outlook for the margin or for the NIM. I know there's a lot of moving parts, but even directionality, flat, down, up, would be helpful.

David Paul Craig

Look, as you would rightly be aware, there are many factors that go into net interest margin, some of which we're not allowed to talk about because of -- we're not allowed to signal. But others of which are just -- anyway, significant moving factors. I think the general guidance I give is that if we can hold NIM broadly flat in any given period, that's a pretty good result. Now in this period, clearly, the cost of funding have been increasing and we haven't been able to fully recover that. But our go-forward scenario is always if we can try to hold things flat, that would be good. But certainly, the longer-term trend has been for NIMs to drop and fortunately, the bank has got more efficient at the same time and has been able to offset those NIM declines with greater efficiency.

Melanie Kirk
All right. Well, thank you. That brings to an end our briefing. So thank you for joining us.