Question and Answer

Operator

[Operator Instructions] Your first question is from Jarrod Martin with Credit Suisse.

Jarrod Martin
Crédit Suisse AG, Research Division

Cameron, Mark, can I just ask a question regarding the SCDO portfolio? Good news that you exited one of the remaining 3. My question's more about the remaining 2, and I know you acknowledged that you'll look for opportunities. Can we switch that around and look at what the potential downside risk and if there is any potential for a write-down on those remaining instruments considering what's happening globally, and then more broadly, within the specialized group assets what the risks are at the moment within that business?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes. Obviously, this fresh crisis is still very young, so we haven't seen any change in the conditions of both instruments. And with the SCDOs in particular, we've always been at the view that we would never lose any money in on it really just in market businesses around them [indiscernible] to consider trading out of them. So to my knowledge, there've been no change in the underlying credit quality of any of the credits in any of the pool. And we've actually been managing the exposures within the pool to take out riskier credit. So we're actually very calm about those things. And if you look back to our disclosures, there's plenty of credit buffer before we have any exposure in the system. So I wouldn't expect that we are likely to experience any kind of trigger events in those things in the foreseeable future.

Cameron Anthony Clyne
Former Executive Director

And I figure out by the broader-ish GA portfolio, Jarrod, I mean, again, that outside of the SCDOs, which obviously have the [indiscernible] effect associated with them. They broadly -- investment client in grade [indiscernible], I mean, there's low returning assets in nonfranchise markets, they're well provisioned, yes, the -- we've been dealing with a fair amount. I mean, this is an interesting point of volatility, but this is kind of a situation normal for us. We've had 3 years of volatility. And the SGA portfolios, the highest as we'd expect throughout that. So again, we're not -- at this stage, we're not experiencing any abnormal or expecting any abnormal losses in that portfolio.

Operator

The next question is from Matthew Davidson with Merrill Lynch.

Matthew Davison
BofA Merrill Lynch, Research Division

My question was just on the business banking margin. Just wondering what sort of magnitude of increase you've seen this quarter. And I guess just looking back, it's been rising ever since first half '09. Just interested if you see it extending beyond this quarter because it appears to have been a pretty strong driver of the positive NIM outcome?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, the NIM is up in the order of 10 basis points or something like that, that order of magnitude, and it does reflect continued repricing. In particular, the bank is active in exiting low ROE, a positive portfolio and redeploying capacities and ROE opportunities but not necessarily individual customers that are paying worth of with the average [indiscernible] portfolio that is increasing. And on the one hand, you'd have to say that there continues to be opportunity to do that. We have no positions we'd like to exit and redeploy.

On the other hand, you'd have to acknowledge that there's a good deal of price competition given the frustration that a lot of business banking franchises have with low sets of credit run. And then very often, you'd find yourself in a tight customer floor for business. So I think that means it's impossible to say that margin will continue to expand, especially we have that other -- a net positive outcome in most periods recently [ph].

Operator

The next question is from Craig Williams with Citigroup.

Craig Anthony Williams
Citigroup Inc., Research Division

After that last response to Matt's question, I perhaps ask how it is that you're exiting low ROE business banking, your credit portfolio quality is improving and yet NIM is rising. It seems like you've found the magic formula.

Cameron Anthony Clyne
Former Executive Director

No, I'm not sure. I think we just try to run the business sensibly. Yes, the helpful thing about a better competition in the market and a bit of liquidity and people came to drive the business banking franchises, it allows you to [indiscernible] some low ROE activity because you've got liquidity in the market. So I think that we look at those as a positive side of the competition, and that does allow us to redeploy the capital into some of the more sticky relationship franchises, cross-sell. And I would expect in the battle off that it's gaining some traction as well. So I just think it's the outcome of some pretty steady management of the portfolio.

Craig Anthony Williams
Citigroup Inc., Research Division

Okay. July would appear to have seen the economy slow a bit further, could you comment on what signs of concern you might have on the economy and prospects for rising bad debt with debt charge in Australia as opposed to broader caution and rational deleveraging occurring by consumers in businesses that's reflected in the slowing credit growth, arising savings and perhaps the prioritization toward paying back high cost debt by credit card?

Cameron Anthony Clyne
Former Executive Director

Well, we haven't -- as we said, I mean, we've seen some improvement in the leading indicators, things like 90 days past due and watch loans improving. The obvious stress spots within the economy are well spoken about. But even that is a simplistic analysis to say mining good, retail bad. It's much more subtle on that is within retail, there are some after retails that are performing well. You've got some geographic mixes. So the moment, what we're seeing is nothing that's suggesting an acceleration in bad debt a bit. Now that is based on a comment at 20 past 9 this morning. The reality is we start to see escalating concerns and other things in unemployment rise, but it's a different ballgame that we're seeing here today. The fundamentals, notwithstanding the fact that there are some pockets, which are well-publicized that have been stretched. The fundamentals are okay, and we're not seeing anything that's going to lead to a material increase in B&DD.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, in the last 2 years, the mortgage [indiscernible] is seasoning much, much better than the traditional seasoning that would seem the newer generation for mortgages have much lower rates of delinquency than [indiscernible] its current norm. Post the flood, we've seen credit cards improve. That is temporarily quite a drag partly because we gave customers the ability to get payments in the credit mobile to pick that up. It's the existing payments rather than skipping payments. And so that's sort of left corrected to a degree. And as Cameron said, business -- we are going through a structural adjustment in the economy, which keeps that [indiscernible] that the business that's inching towards the positive. SG&A has been very well behaved, U.K. has improved, New Zealand's improved. So we're already 1 month into the next quarter, but we don't see anything that changes the pattern we reported there.

Cameron Anthony Clyne
Former Executive Director

I mean, you asked us what's the number we watch, it's unemployment because when unemployment begins to rise, then clearly, you've got obvious implications to potentially be a mortgage book because they will start to have a genuine difficulties in dealing with that. And obviously, that's a valid impact into the business credit market. If unemployment remains relatively benign, notwithstanding the fact that their are pockets, then you can have catalysts from -- there's opportunistic signs of confidence. I mean, an example would be that the outbound travel, the 25th 5-year high since consumers will pay the opportunity [indiscernible] a bargain. If unemployment's rising, you don't have those sort of events occurring and you genuinely got concerned. So it's unemployment, so that's the thing we're watching, and in fact, does a trend up obviously, that's a different ballgame. But you see here today, we're not seeing that -- we're not seeing that through our business survey today, yes, significant plans for companies to shed labor.

Operator

The next question is from Rich Wiles with Morgan Stanley.

Richard E. Wiles
Morgan Stanley, Research Division

Mark, in the first half, the retail banking cash profit was flat on the second half of last year. It was mainly due to the higher impairment charges, you mentioned the collections on the credit cards. Your statements today suggest that impairment charges has gone back to perhaps the second half levels. Could you confirm that? And could you also comment whether the preprovision profit dimension that you experienced in the first half is being maintained in this latest quarter, please?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, on the Personal Bank, the B&DD charge, I haven't got the second half hit in front of me, but the third half '11 is down to a material degree. And the underlying profit is also up in the order of low double digits.

Operator

The next question is from Mike Wiblin with Macquarie.

Michael Wiblin
Macquarie Research

Just a question on your asset growth. If I look across your sales versus the other majors, you've been growing at a pretty rapid rate. Just given the global macro situation's changing relatively quickly, when do you start to take a little bit more of a cautious stance? And are you having those sorts of conversations at this point in time?

Cameron Anthony Clyne
Former Executive Director

Well, I mean, I think we're always looking at the shape of the portfolio. We've been happy to grow in mortgages. As I've said on many occasions, that's allowed us to put diversification in the balance sheet. That's opened up the capacity to reshape the business portfolio, which we've been doing. Even with that relatively rapid growth, we're taking the opportunity to strengthen the mortgage quality. Our mortgage quality and our mortgage statistics are significantly better now, the growth we're having and we're growing a path towards the system. We're a much more sophisticated risk-based pricing particularly through the third-party channels. And even with that rapid growth, I mean, we still remain at full 10 or 11 percentage points below market share levels of other CDPs. So I don't think we've got an undue level of concentration, and the seasoning is remarkably consistent with what we've been in our historical vantages. So we're always trying to manage the portfolio. We don't get up each morning and say, oh, geez, the Dow's down 600, let's run around and run the business differently. We've been around for 153 years, we get up and obviously get behind those sort of things and you look at the funding implications. As Mark said, we're done on risk funding. So at the moment, we're pretty comfortable with our position and we'll continue to take share while it makes sense.

Michael Wiblin
Macquarie Research

And just on the funding cost side of things. I mean, if things were to continue to trend up, but it's not at the CDS are sort of sitting around 150 basis points now. Does that change your aggressive growth strategy in business and mortgages?

Cameron Anthony Clyne
Former Executive Director

Well, I guess it brings back to the fore the challenges of repricing and as we see the average cost of funds rise. I don't think we sweat the cost of funds too much because the Australian banks have high degrees of freedom around pricing albeit that it becomes a political issue from time to time. The thing that's much more important is liquidity and access funds.

Operator

Your next question is from James Freeman with Deutsche Bank.

James Freeman
Deutsche Bank AG, Research Division

Just wanted to see if I could get a little bit more color around the margins, particularly you mentioned there are some improvements in the funding costs. Just get an idea that might be the deposit side or is it rolling off of expensive debt from the middle of the global financial crisis. And then what do you expect to happen on the deposit side of the business. Obviously you're getting very good growth there, as the consumer deleverages. Do you expect that you'll be having opportunity to reduce rates in that part of the business in the near term?

Cameron Anthony Clyne
Former Executive Director

Well, I don't know, but that does get in three ways of deposit competition, but the comments I made did reflect a slightly relaxation in retail deposit pricing. As you say, flows are very good and being really quite helpful and during a period of soft credit growth, that gives you the opportunities to strengthen the balance sheet. And I think it makes the banks generally fairly relaxed as they're all seeing good growth. Occasionally that you get a bit of a pickup in margin and then occasionally you see heightened competition as well. So we just happened to have a period where there was a degree of relaxation going through it.

James Freeman
Deutsche Bank AG, Research Division

And I guess can I get an idea just of the underlying revenue growth of MLC? You mentioned personal and business banking and wholesale, but nothing on MLC?

Cameron Anthony Clyne
Former Executive Director

Yes, MLC was a little bit soft. I think some in the period fell from 121 to 123 or something like that, so it's slightly soft. And a bit more lapses on the insurance side. So it wasn't strong but it wasn't a significant backward step.

James Freeman
Deutsche Bank AG, Research Division

But negative revenue growth?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Sorry?

James Freeman
Deutsche Bank AG, Research Division

But it wasn't negative revenue growth?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, slightly. I guess, it's still past average.

Operator

The next question is from Brian Johnson with CLSA.

Brian D. Johnson
CLSA Limited, Research Division

Gentlemen, Mark, I just had a question on liquidity. At the first half, you highlighted as one of the headwinds going forward, liquidity reform. Could you give us a feeling on basically are you talking about the quantitative liquidity you've got a hold or what liquidity is, and when we should expect to start to see some kind of negative drag of that coming through?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, basically -- again, we haven't got clear enough line of sight to say exactly what we need to implement. We do know that we need to change the composition of the liquidity holding towards things that will be more expensive to hold and it will be more onshore, we hope, a bit of liquidity in London for example. So I think foreign sovereign and things like that would not be acceptable under the new regime or to a much lesser extent. So we will have to reshape that portfolio and the cost of holding will rise. And then the cherry on top will be having to pay sort of the reserve bank support facility, as well. So I think it will become a lot more expensive but at the moment, we're making very minor steps in that direction, trying to focus on the Australian sovereign and semi-government and things like that. So just try and take a bit of a bite of it. But hopefully over the next 6 months, we'll get a clearer view of that, and that's better quality across of the impact.

Brian D. Johnson
CLSA Limited, Research Division

So, Mark, basically the deadline at this stage and it's really hard to read through all the efforts and stuff on it, but I'm suspecting it's still 1 January 2015, we've got to be there whatever it is?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes. Whatever the gap is at that point, as long as you have behind yourself and taken the transition seriously and done what's within your power reasonably to do, then the reserve bank facility will be seeing the flow again.

Brian D. Johnson
CLSA Limited, Research Division

And that will be charged as some kind of market growth?

Mark Andrew Joiner

Former Executive Director of Finance and Executive Director

Presumably.

Operator

The next question is from Dan Cook [ph] with Goldman Sachs.

Unknown Analyst

Just a quick question on the funding cost. The question is going to elaborate on that a bit more. Given the price moves that you're seeing and given the potential for rate cuts, how do you see deposits pricing going forward? Do you see that as a risk on the margin? And then also just tying in with that last comment that you made in liquidity facility, when do you expect the banks to start pricing that in on deposit pricing as well and basically reflecting the fact that some of these online savings deposits will be less valuable than some of the time deposits pricing, can we get a feel on that, please?

Cameron Anthony Clyne
Former Executive Director

I think -- we have no crystal ball on what's going to happen with deposit pricing, but I guess the conditions are for people to stay fairly relaxed around deposit. Flow is strong. And if this crisis have anything, it might strengthen the flow, strength of credit growth is likely to be lower. So all of the things point to reasonably relaxed settings on the deposit side. You're quite right that under Basel III certain parts of deposits are more valuable than others. And when they're lumpy or hostile in nature, you do have to hold liquidity against them effectively, which makes them quite expensive. So we have actually been cognizant of that, and actually averaging or moving the center of gravity of our deposit portfolio towards the things that are more Basel III-friendly. So that's something that all of the banks are no doubt engaged in, and will change, not on offer, certain types of customers, based on the Basel III effects on both the products. There will be some changes in market pricing from that as people assimilate the new rules.

Unknown Analyst

And just a brief point of clarification as well on the capital comments that you mentioned. You said the SCDO exit has been reflected in the capital ratio, but did do you also take into account to state a post tax impact on the exiting offer of the SCDO position in that 20 basis point improvement in your core Tier 1 ratio over the quarter?

Cameron Anthony Clyne
Former Executive Director

Sorry, I didn't quite catch that.

Unknown Analyst

You mentioned that when you exited the SCDO portfolio that's been reflected in your core Tier 1 improvement over the quarter. But I just want to understand if the earnings impact has also been reflected in that core Tier 1 movement or if earnings impact have yet to, be I guess, pro forma-ed into that ratio?

Cameron Anthony Clyne
Former Executive Director

The trading out of the late 2 from the 4 instruments gives us a significant capital relief, which is accounted for in the capital. Similarly accounted for in the capital is tear-up cost in the mark-to-market during the period. What is not accounted for in the capital year is the $360 million remaining unamortized hedging cost, which we'll certainly see amortized over the next 7 years. So on a tax-adjusted rates of bank, it will probably move about 6 to 8 points of capital. So we have further upside to come from trading out the last 2 and we have a headwind of probably 6 basis points when we do the clean-up accounting.

Unknown Analyst

So when you put all that together. I guess it's still going to leave you a capital ratio of slightly below the average of your peers on a core Tier 1 basis. Is that a position that you're happy with like in terms of relative sense understanding from absolute sense the capital has areas that it looks like it could improvement longer term, but in a relative sense, it still looks a bit on the weaker end?

Cameron Anthony Clyne
Former Executive Director

We're probably in the order of -- once the Basel III adjustments are known and incorporated, we're pretty close to 7% core Tier 1, and we do expect to continue to trend upwards over the next 18 months or so. We do have good core capital generation in the business now and with low effective credit growth. We are in the process of downgrading our forecast for such a credit. That should continue to improve. But we also have lots of flexibility around DRP. We have hybrids that may or may not convert, et cetera. But we know we're on a journey to 7.5%, probably it's a range of 7.5% to 8%, but we don't actually know where that's going to settle and why. We just know we have to keep moving in a positive direction. And as I said, we have high degrees of flexibility in how we manage that. So we'll just adjust as we go along. So I guess on a peer relative basis it is slightly at the lower end. I don't suppose we would do anything other than we are doing, which is just generating capital and moving in the right direction.

Operator

The next question is from Scott Manning with JP Morgan.

Scott Robert Manning
JPMorgan Chase & Co, Research Division

I was just hoping you could offer some direct observations of what you've been seeing in offshore hostile funding markets over the last weeks and months. And particularly given the volatility there and just the extent which you tend to get out of the market. To arrive at 30 to 40, you need to engage at these higher spreads?

Cameron Anthony Clyne
Former Executive Director

Well, again, the spreads don't worry us, specifically. I guess what we would see, when you get a crisis like this, there tends to be a flat quality, which can sometimes help us. But what you also see is there's no duration in the market and everyone goes short, which is not the way we want to issue. We want to issue long term but it sort of creates a bit of indigestion in that sense. But in terms of our issuance intent, we're pretty much down on this year as we've clearly highlighted. But if we see the right conditions, we will continue to issue, but we don't have to. And probably in the next, I think, in 4 weeks' time, to go and track out anyway. And then we emerge after our full-year results in November. So I think it's the state of the market in November that is most relevant.

Operator

Your next question is from Jonathan Mott with UBS.

Jonathan Mott
UBS Investment Bank, Research Division

I've got just have a question following on from Dan. On the credit risk-weighted asset reduction that you talked about, excluding the synthetic CDO, could you comment on how much of the reduction came through from price cyclicality and how much came through optimization of the credit asset position? And how much more of the optimization you think you can keep working on?

Cameron Anthony Clyne
Former Executive Director

This is a combination of 2 things. I haven't got the proportions in front of me, but we did continue to work on optimization. And really, what that optimization reflect is perhaps to positioning of the business to optimize itself under Basel II. And if you remember, that was playing catch-up from Basel II and probably it didn't cross the line in a very sophisticated state. And so there are plenty of opportunities for us that we need to work with our regulator on systematically. So we get ourselves Basel II match fit, so we probably have $80 billion to $100 billion of RLWA released over 3 years. And each year, we refresh that agenda and we go on to the next round and so that -- we expect that to continue.

Operator

The next question is from Andrew Lyons at RBS.

Andrew Lyons
RBS Strategy

Due to conditions in your trading businesses, I'm just wondering just in recent weeks in light of market volatility, if you have noted any improvement, and if we did see volatility continue, would you expect this line item to be somewhat kind of cyclical once again?

Cameron Anthony Clyne
Former Executive Director

Yes, absolutely. It was a very valuable contributor in the downturn from sub-LIFO borrowings as well as the volatility in risk markets. And so we would hope that we would provide good conditions for treasury in the Wholesale Bank.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Because a big part of it, obviously, will have business bank customers seek is protection on both FX and interest rates, they haven't been looking for a lot of that and if you get volatility in both those line items, basically we expect see risk management activity increase. So if we have them in risk volatility necessarily on the market, our traders would be able to benefit from that. But it's still too early...

Cameron Anthony Clyne
Former Executive Director

[indiscernible] customer pricing.

Andrew Lyons
RBS Strategy

Sure, but it's actually too early to say, you're actually seeing that today?

Cameron Anthony Clyne
Former Executive Director

Absolutely, yes.

Operator

The final question is from Ben Zucker with CBA Equities.

Ben Zucker
Commonwealth Bank of Australia, Research Division

I just wanted to get bit more of a sense of how you're thinking about growth. You mentioned, I think, before that you're in the process of downgrading sector forecast. And I know we've talked about pipelines in the past and that's not always translated through. But what can you say, I suppose about what you're seeing and what you're expecting going forward, particularly on the business side?

Cameron Anthony Clyne
Former Executive Director

Well, I think the pipeline is either factual pipeline, it's just what you've got is confidence, meaning that the movement through that pipeline is fairly slow. The reason we're confidence in the pipeline is that in fact the business credit rate having been negative have now been slightly positive or negative last time and probably positive this year. We've not necessarily been talking about at least credit expectations of expansion, it's just actually core replacement of capital. So whilst we think the credit growth will probably be lower next year, we still expect it to be positive. And in fact, we're probably more comfortable it's slightly positive because of the fact that it's been put off to some to years and it's gotten in many cases to a point where we are seeing some of the early signs of them pursuing basic expansion if not for expansion reasons just for replacement reasons. So we expect credit rates to be positive next year.

Ben Zucker
Commonwealth Bank of Australia, Research Division

And that's on the business side?

Cameron Anthony Clyne
Former Executive Director

Yes, the business side. Yes, absolutely. I'm only talking here about SMEs. I mean obviously, you'll get a little bit into the hybrid at the corporate end as you always do in different routes to market for them. We've been very, very active in the U.S. BC market for example and that's been good for us. But if you get into the SME part of the business where the commercial bank is their only source of finance, we may not see that. We're not obviously expecting the double-digit growth we saw pre-'08, but clearly, the economy basically can't sustain credit rates below GDP. You're not replacing core inventory and stock and that's what we've been doing. So even if you have a -- even a bearish outlook of the economy, you still got to get probably GDP just slightly past GDP credit growth.

Ben Zucker
Commonwealth Bank of Australia, Research Division

So just to be clear, then, in terms of the credit rates you're talking about, you still expect that to be predominately SME-led, possibly still offset by some further fee gearing at the upper end not necessarily on loan bank.

Cameron Anthony Clyne
Former Executive Director

Well, it's hard to say. But I'm just saying is to me, clearly where the commercial banks are the prime source of finance, so that [indiscernible] credit growth.

Cameron Anthony Clyne
Former Executive Director

Well, thank you, everybody. I'm sure that it will be a fascinating day. So we're, of course, on the business, you still get a mortgage and credit card transaction account in the business line this morning, so the bank is still working. So enjoy your day, and we'll be back for the full year results in a few months. Thanks.

Operator
This concludes today's conference call. Thank you for your participation. You may now disconnect.