Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Jonathan Mott of UBS.

Jonathan Mott
UBS Investment Bank, Research Division

Mark, I just want to go back because I have a question, the commentary you just had about the U.K. Well, you topped-up another GBP 100 million of capital into the U.K. Can you just elaborate on that? Where are you now on the Basel III Core Tier 1 in the U.K.? And given this top-up, can you give an ROA above the cost of capital in the future years out of the U.K. business?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, I haven't got the Core in front of me. But the Clydesdale Tier 1 ratio on an FSA basis, of course, is 11.2%, which...

Jonathan Mott
UBS Investment Bank, Research Division

So is that Basel II or Basel III?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Basel II. And that compares with 12.2% for the group. So Clydesdale has typically maintained a Tier 1 ratio on a like-for-like basis that's behind the group. And so while it's quite visible us continuing to top-up the capital in the U.K., in fact the amount of capital going in there is very much in line with what's been going on at the group level.

Jonathan Mott
UBS Investment Bank, Research Division

And once you roll forward on to Basel III, do you have indication of where that would get to?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, let's just say, we're at a -- we're in a good equilibrium with our regulators at the moment. But who knows exactly when the whole deliberation is over? But as far as having met what the regulators have asked for and responded to the triannual review of the pension, we're done on that.

Jonathan Mott
UBS Investment Bank, Research Division

And also ROA. What was the ROA of the U.K. business in the quarter? And can you get that to your cost of capital?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, obviously, Cameron has announced that it's -- that we're undertaking a review of the whole business and that, that review is, of course, targeted to bring the whole business back to an ROE above the cost of capital.

Operator

Your next question comes from the line of James Freeman of Deutsche Bank.

James Freeman
Deutsche Bank AG, Research Division

Mark, I just want to follow up on trading revenues just to get an idea as to where they are versus what you consider to be a normalized range and how much of this is sort of strength coming back the other way?

Cameron Anthony Clyne
Former Executive Director

Trading revenue.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Oh, trading revenue. Well, it's been a strong quarter. I think if you remember the fourth quarter of last financial year, it was a very weak quarter because we had that big swing in sentiment on interest rates. And I think I estimated at the time that it took, across the bank, took about $200 million out of revenues out of that result, not all of it in the Wholesale Bank. So obviously, there's been a bounce back from that because it doesn't recur. But there's also been a higher level of sales activity amongst customers, and we have been working on improving the cost flow. So I think it's up 40% on the average, but I think the run rate we had in the last quarter was better than the run rate in the third quarter last year, which was before we really tripped up. So..

James Freeman
Deutsche Bank AG, Research Division

All right, that's -- so my -- just to confirm, it's up 40% on the average?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

On the average of the last 2 quarters, correct.

James Freeman
Deutsche Bank AG, Research Division

The last 2 quarters, right. Is this what you would consider to be a normalized range? I mean, are you back to normal yet or -- from trading revenues?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, I don't know what's normal anymore. So, I mean, it was a healthy quarter. Not extraordinary but healthy.

Operator

Your next question comes from the line of Craig Williams of Citigroup.

Chris Williams
UBS Investment Bank, Research Division

U.K. franchise now seemingly loss making, I would have imagine from doing some rough math. But profitability has sort of been in decline for some time, and the economy has been difficult for years. So what's now triggered the decision to take the strategic review? And can you discuss what sort of options you consider for it in your review? Is it about putting the book in run-off and reducing costs, disposal of the business, et cetera?

Cameron Anthony Clyne
Former Executive Director

Well, the business is not in loss. That's the first point. And look, it's a fair question to say, "Why now?" You can say, "Why not in the last 25 years?" But I think when we looked at the business in March '09, the environment was very unstable in the U.K. You had the government equity injections, you had a whole range of reviews going on, PPI, everything else. We felt at that point in time we weren't happy with the returns from the franchise, that to continue to operate in its current format was acceptable. And that has been acceptable throughout the last couple of years. What's become apparent now is that the -- whilst there were signs of recovery over the course of 2011, our view is that now, that that's likely going to be a much longer return. The U.K. will be within recession. Europe will be in a much more prolonged recession. The market has also somewhat stabilized. You've had the mandated divestments now out of RBS and Lloyds. So you've got a more stable market structure. So we think now is the right time to review the business and get it on a path to having a better return. In terms of options, we're not ruling things in or out here today. What we have said is that we're commencing that review. The objective is clearly to improve the return on the business. We anticipate that we can report back on the findings of that review and the implications at the latest by our half year this year. I wouldn't suggest that -- well, the reason that we can do that -- I wouldn't suggest that we've been absentee landlords over that 3 years. We've also been thinking through improving the returns in the business over that 3 years now. We see an opportunity to trigger an acceleration of that review, and we'll come back with the -- as I said, what -- the recommendation and implications of that before the -- at or before the half year.

Operator

Your next question comes from the line of Victor German of Nomura.

Victor German
Nomura Securities Co. Ltd., Research Division

Mark, my question relates to margin. I think the reported margin for the quarter was a little bit lower than consensus was looking for. If, firstly, I could get a sense if there was any volatility between interest income and noninterest income? And also, just on the outlook for margins. As you mentioned, you've raised a lot of term funding at much higher costs in January, which obviously goes into the next quarter. Would you be able to give us a sense for what's happening on the asset side? I suspect you're not going to be able to comment on the standard variable line. But outside of housing, particularly in business and institutional, what's the opportunities to continue to reprice that book in order to cause some of the margins back?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, there was some accounting noise in this margin outcome, and it was actually helpful. I think we got a 6-basis-point uplift out of that. So the underlying is probably even weaker. But the outlook depends very much, as you surmise, on what happens on asset pricing from here, because there's no doubt that the wholesale funding costs and the term deposit costs have both jumped substantially. They jumped during the quarter. So you don't necessarily see the full effect of it in one quarter. But if that position is sustained over the rest of the year, you get a substantial headwind in the industry. So it remains to be seen where the market settles therefore on the price of our assets.

Victor German
Nomura Securities Co. Ltd., Research Division

And your current -- your -- the current trend in asset prices -- in asset spreads on institutional business bank? Are they improving or deteriorating?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

On the high end of institutional. I'm sorry, I don't know. Gee, I can't...

Cameron Anthony Clyne
Former Executive Director

I don't think we don't want to get in there. I mean, the reality is that we don't want to get into asset price forecasts. I mean, Mark's analysis is quite correct. There has been a significant increase in both the cost of deposits and the term funding. If that holds without repricing, that will have an impact on margin. The nature of repricing in some facilities, particularly institution and -- have automatic repricing capability, others don't. So it's very, very hard to predict the outlook for margin.

Operator

Your next question comes from the line of Jarrod Martin of Credit Suisse.

Jarrod Martin
Crédit Suisse AG, Research Division

Mark, Cameron, just back to the U.K. and around the asset quality side, I just wanted to get some more color around the extent to which you think the increase in bad debt this quarter is a blip or there is a trend emerging? Also, noting your comments, Cameron, around the prolonged recession in Europe and the U.K. and whether that's partly triggering your review of the business.

Cameron Anthony Clyne
Former Executive Director

Well, I think it's one of it triggers because I think, as I said, we felt that the economy was at least bottoming last year and now that's not the case. One thing I didn't -- one thing that this is having an impact on the market, which I didn't reflect, which is also a fact, is that Mark did mention reduction in collateral value. That is partly because the banks that have significant government ownership are in fact accelerating some write-offs in that market, which is affecting collateral. And that's become clear. That's always been a -- Mark -- his bet is coming to fruition. That's also been a trigger. That's why this market is now really going through some structural change. And therefore, we want to trigger now for time to commence a review of it. In terms of where the trends are going, I mean, that's what we factored in. We think the economy is now in for a prolonged recession. The -- but based on what we see at the moment, the book is appropriately provisioned for the environment that we're in.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes. So if you tear apart the 90-day past due and the gross impaired assets, the gross impaired assets-to-GLAs has continued to fall, but the 90-day past due has jumped up. So the 90-day past due in March was 80 basis points. In September, it was down to 57, and now it's back up to 77. So you'd have to say the lead indicator is showing weakness, not sort of out of the ballpark, but a reversal in the trend.

Operator

Your next question comes from the line of Ben Koo of Goldman Sachs.

Ben Koo
Goldman Sachs JBWere Pty Ltd, Research Division

Just a question on costs. And it's best for you to do more work on the cost line given you've been highlighting this significant margin deterioration at the group level. The bad debt environment in the U.K. as well has been problematic in Australia. So not looking like the current environment has been, I believe, partly cured is probably a better way to term it. What more can you do on the cost side just to try and improve the pre-provision outcome on your bottom line performance?

Cameron Anthony Clyne
Former Executive Director

Well, the -- we're not certainly flagging any major cost initiatives as a result of this. I mean, we've been pretty good with general costs for the last 3 years. I think our cost performance has been pretty strong because, I mean, we recognize that in this environment, there's a lot of levers that are outside of our control, but the one that's in our control is cost. So we think we've had a pretty good cost outcome. So this doesn't, in our mind, trigger an acceleration of costs or imagine a cost premium. We just say we have to continue the cost focus we've got because that is our lever that we can control. Okay. And the other really is obviously the investment we've got to maintain. We are committed to continuing the rollout of our transformation. It's not just the core banking platform or the network transformation and the infrastructure transformation. And we're pleased with progress, and we're certainly hoping towards the middle of the year we'll be able to report some quite significant progress, for example, in the core banking platform. We've got to maintain that as well. But there's nothing new to report on costs. It's just we've got to keep working hard at it because that's the lever we can control.

Operator

Your next question comes from the line of Brian Johnson of CLSA.

Brian D. Johnson
CLSA Limited, Research Division

Just 2 quick questions, if I may. The November rate hike, when you guys maybe called back 5 basis points with the housing differential relative to your peers, is the exit run rate margin actually higher or lower than what it was for the quarter? That's the first question. And the second one is that, I wouldn't mind, Mark -- can you just go back through and explain to us again the top-up provisioning you've put in the U.K.? I'd be particularly interested to work out is the provision coverage against the U.K. commericial real estate still kind of around the 11% or has it significantly increased from that level?

Cameron Anthony Clyne
Former Executive Director

Honestly, we thought the market -- on the exit run -- I mean, the reality is that repricing only came in very late in the quarter, so we haven't had a full quarter impact of that.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes.

Brian D. Johnson
CLSA Limited, Research Division

But Cameron, the...

Cameron Anthony Clyne
Former Executive Director

If the differential maintains, then obviously that will -- that would -- in relative terms to peers would have -- would be positive.

Brian D. Johnson
CLSA Limited, Research Division

All right, correct. That's excellent. And the one on the commercial real estate in the U.K.?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, I haven't got commercial real estate separately, but the specific provisions to gross impaired assets in the U.K. has risen over the quarter from 15.9 to 19.

Operator

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

Matthew Davison
BofA Merrill Lynch, Research Division

Mark, I just wanted to delve a bit deeper on your comment that the NIM decline would have been worse than the 9 bps if you took out the accounting noise. I'm just wondering what other factors would have driven that beyond the 6 basis points you talked to cost of funds and the additional liquid stuff if you reversed out the accounting noise.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, so I guess the main elements of it would be we -- as Cameron said, we got a slight uptick in the lending margin from the repricing, but we only got one month from that really. So we pick up a couple of basis points in pricing, we lose 5 basis points in mix because of the skew to mortgages, we lost 4 basis points in deposits and other another couple in wholesale. And we called in higher liquid assets. So we're spreading the NOII [ph] across a bigger base, that cost 4 basis points. So they're the main elements.

Operator

Your next question comes from the line of Richard Wiles of Morgan Stanley.

David F. Shi
Morgan Stanley, Research Division

It's actually David Shi here. I just wanted to ask regarding margins in the quarter. What was the impact or what impact did the U.K. margin have on the group margin? And also, what was the actual fall in the Retail Bank margin?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

The Clydesdale margin impact on the group would have been negligible.

David F. Shi
Morgan Stanley, Research Division

Right.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

It may be 1 basis point or...

David F. Shi
Morgan Stanley, Research Division

And how about the Retail Bank margin? What was the fall in that?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

In Australia?

David F. Shi
Morgan Stanley, Research Division

Yes, the Personal Bank.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

The Personal Bank would have all the things I was talking about before in it, like the lending mix skewed to mortgages, the headwinds from the term deposits and a higher transfer price out of the central treasury as well. So the Personal Bank -- well, both the Australian core lending businesses, the NIMs are down. The Personal Bank's down more than the business NIM.

Operator

Your next question comes from the line of Mike Wiblin of Macquarie.

Michael Wiblin
Macquarie Research

Just a question around the SME side of things. You obviously had an uptick in the second half last year. It looks like it's been relatively well behaved in the first quarter. I guess given what's going on in the economy and things are feeling a little bit softer, can you just give us a view of the outlook there, particularly, I guess, on the retail side of things and also on [indiscernible]?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, the Business Bank, bad debts in aggregate, are reasonably flat. But for the SME segment, they're down. So SME is actually traveling better. Whether that's a trend and should be extrapolated, I mean, who knows? You have to take an economic view.

Operator

Your next question comes from the line Brett Le Mesurier of BBY.

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

How much of the increase in revenue in the first quarter was due to sales and trading and Wholesale Banking? It seems like just about all of it was. Would that be the correct conclusion?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

It was a heavy contributor. MLC was the other business that was stronger. But most of the banking franchises were pretty flat.

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

Okay now just a couple questions on the U.K. I presume that there was very little change in the collective provisions in the U.K. Is that also correct?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

That is correct.

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

And lastly, is there any part in the U.K. business that has an ROE greater than 15%?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, it depends how finely you want to segregate it. I'm sure I can find some stuff that's over 15%.

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

I think that's an answer.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Correct count [ph].

Operator

Your next question comes from the line of Ben Zucker of CBA.

Ben Zucker
Commonwealth Bank of Australia, Research Division

Just had a question for you around funding strategy I suppose from here given all the impacts on NIM, given where you view markets at, at the moment. What are your thoughts around or expectations around competition in deposits and possibly need for higher liquids as well?

Cameron Anthony Clyne
Former Executive Director

This is -- this is the same statement for the last 3 years. Competition for deposits will continue, though there'll be periodic lulls and ceasefires, followed by frenzied activity. And that's the reality. And that will depend on periods when the markets are very heavily priced or closed. But in terms of funding, it's going to be -- what we are seeing is capacity, I mean, we're obviously very comfortable with that funding position. A lot's going to depend on credit demand. And as credit demand remains weak, then that gives us more optionality around the funding profile. And at this stage, credit demand, while call it business consumer confidence is where it is, I mean, we anticipate credit demand being relatively subdued certainly over the next quarter or 2.

Ben Zucker
Commonwealth Bank of Australia, Research Division

So it's still a priority to keep deposit inflows high now?

Cameron Anthony Clyne
Former Executive Director

Well, we -- I mean, the reality is we are still tracking to a 28 [indiscernible] objective in terms of the net stable funding ratio. So you can always consider that to be a long way off or you can recognize that you've got basically your ratios relatively in shape. So we do still want to maintain a reasonable flow in deposits. And obviously, we will skew that flow through deposits that we think have high value. We're starting to get more clarity on those deposits that have a high value. And then, obviously, you have to balance it off about what term issuance we can do in the market as well and at what price.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

But having priced up deposits as an industry, I think we're doing more to attract flows than to try and take it off other players. I think the whole industry is just priced to make it a more attractive asset class, and that's what we need to do. There's no point playing aggressively in a zero-sum game.

Ben Zucker
Commonwealth Bank of Australia, Research Division

And what about liquids, just with the way markets are at? I mean, you obviously have to lift that. And still on that sort of defensive tack and possibly looking to continue to increase liquids in this environment or...

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, we have planned to and executed a rise in liquids. There are still some moving pieces on that as to how far we need to go on it. But I think that more of a need to adjust the mix of liquids and get the quality in line with where the regulators want it, rather than materially increase the level certainly at this point. But the regulators do occasionally change their mind on what a good liquid asset is. A year ago, they thought it was a sovereign, and now they're not so sure.

Operator

Your next question comes from the line of TS Lim of Bell Potter Securities.

T.S. Lim
Southern Cross Equities Limited, Research Division

Just there's a lot of rain up north, and I'm just wondering, are you guys going just put a new overlay for the potential damage from the floods?

Cameron Anthony Clyne
Former Executive Director

Not at this stage, or did ever -- we've had a review of the agri portfolio yesterday. At the moment, the -- obviously, there is some crop damage, but it doesn't have the characteristics of last year's floods, which were flushing [ph] nitrogen [ph] and does infrastructure damage, particularly the fencing and other things. So -- and in some cases, the floods won't peak in parts of Western [indiscernible] until March, so that there's a fair amount of time to prepare. There'll be -- there is certainly some crop impact. Obviously, the cotton impact in Northern [indiscernible] in Queensland we are watching, but we don't see at this point any need for a material overlay in the agri portfolio.

Operator

Your next question comes from the line of Craig Williams of Citigroup.

Andrew Minton

Actually, Andrew Minton here. Just a quick question on the U.K. review. Would there be any prospect of a restructuring charge that we should expect associated with that review? And if so, would that be taken above or below the line?

Cameron Anthony Clyne
Former Executive Director

Yes, I don't want to get into that. Look, there's any myriad of options, and I wouldn't want to close off people's speculation, and I will enjoy the next couple of months. What we are committed to is to come back as quickly as possible, and as I said that's what we're going to do. If we can do it before, coming out with the answer, before the half year, we'll do it. Otherwise, we'll wait at the half year. We're not ruling things in or out at this point.

Operator

[Operator Instructions] And your next question comes from the line of Brian Johnson CLSA.

Brian D. Johnson
CLSA Limited, Research Division

Just a quick question for Mark. Mark, on the capital position, we see a lot of quarterly volatility for the banks at and above the capital generation based on things like the interest rate risk and the banking book. Should we expect to see anything, any kind of weird, volatile things coming through that have helped out or injured during the quarter?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, the only sort of volatility, I think, that I can think of is I think we picked up a couple of basis points from some of the accounting noise -- some hedge ineffectiveness that might easily reverse. But it's that order of magnitude. It's not going to change the story.

Brian D. Johnson
CLSA Limited, Research Division

And Mark, has the capital transfer that you've putting into the United Kingdom, which is now quite a substantial number, should we be starting to think about a gearing constraint on the Australian business at all? I know it doesn't impact the group capital, but the regulator, the Australian bank entity?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, no. I mean, as I said at the beginning, we're focused on it because it's separate and visible. But in fact, the Tier 1 ratio on an FSA basis in the U.K. is lower than at the group level. So it's no more a recapitalization than it has gone on in the Personal Bank or the Business Bank or the New Zealand bank for that reason.

Brian D. Johnson
CLSA Limited, Research Division

But Mark, it's even lower than [indiscernible] Numbers because the FSA way of doing it is just so much more generous than the [indiscernible] anyway, isn't it?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, the calculation is different, but the benchmarks are different from where you expect it to sit.

Cameron Anthony Clyne
Former Executive Director

But nothing we've done to the U.K. in terms of capital or any other support, anything else, had in any way constrained our ability to execute in the Australian franchise in the last 3 years.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

We might close it here. Thank you very much.

Operator
That does include our conference today. Thank you for participating. You may now all disconnect.