Question and Answer

Warwick Bryan
Former Investor Relations Contact

Thanks, Ian. I'm sure we all know the ground rules, but I'll just repeat them quickly. [Operator Instructions] So Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. A question on Page or Slide 47. You've got the RBS, so the retail margin which has been a great driver of growth for the last few years if you re-priced out post the GFC, and you've got back to that level. Now you've just seen that start to peak. It's down 2 basis points, and I know you called out basis risk is one of the reasons. But more fundamentally, have we got to a stage now where the retail margin expansion has now peaked, and we're now likely to start seeing ongoing pressure coming through on the retail side of the business rather than the group specifically?

Ian Mark Narev
Former Executive

Jon, as you know, there are a number of different factors that go into the margin. David's pointed out that in this particular period, the biggest driver of that 2-basis-point decline overall was the basis risk. And a big driver of that has actually been the impact of the changes in FX on the prices of swapping back overseas funding, the impact that's had on the BBSW here locally. In terms of how this looks in the near to medium term, the driver is, number one, and we've said this for quite some time, when you're in this kind of environment, your basic assumption has got to be it's only going to get more competitive. And that's why for a large number of years now, we've had this focus on productivity because the underlying assumption has been the market is going to be more competitive. Now what we've shown over, again, a large number of years, is that in that environment, we will be very careful about where we choose to grow. We'll obviously want it through their customers, but we'll disproportionately look to areas where the margins are a little bit better. And that's why we've been underweight in a couple of areas of the home lending market, which we believe the returns aren't quite as attractive. In terms of the funding cost side, at the moment, the environment's pretty good. Subject to the basis risk that we talked about, we have to watch that very carefully. But my assumptions as to the funding costs are probably about as good as yours are, so when you put all that together, our basic assumption in this environment has always been you've got to be prepare for a little bit of margin decline, and the way you manage that is through careful margin management, good product and good focus on productivity.

Warwick Bryan
Former Investor Relations Contact

Jarrod, and then to Craig after that. Thanks.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Ian, you're right to point out that the IBI has been managing the transition from mining to non-mining by allowing it to stimulate the construction sector. Another factor of that is what we're seeing is very robust house price growth. And if you look where the dollar is now and some of the signs you've seeing, we're probably closer to the end of that stimulatory action than to the start. So what are you doing in terms of your mortgage book and your outlook on that sector? And is this the time that you should be starting to pull back within home lending because this is the time that you write those bad loans?

Ian Mark Narev
Former Executive

We -- you're a very bright man making predictions on whether their bank is in a feeding cycle. But look, seriously, we've, again, been in this lower interest rate environment for a little while, and the risk that you've outlined [indiscernible] that good banks, and I think all the major players in the system are like this take very seriously, which is the need to make sure your lending standards work through the cycle. Our view here, number one, there's a lot of focus on LVRs, particularly from APRA. Our #1 focus, in addition to prudent lending there, has been making sure that servicing is able to withstand a rapid increase in the interest rate environment. And if interest rates continue to go down, we don't put the floor rate down because it's already blown through the level at which we would be comfortable doing it. So we're confident at the moment that our -- the risk appetite we have in home lending is appropriate for the environment we're in, even if it was a little bit more even. But as you say, these low interest rate environments produce sometimes rapid rise in assets, and we've got to be very careful about it.

Jarrod Martin
Crédit Suisse AG, Research Division

Second question for David. Risk-weighted asset growth outstripped lending growth in the half. Didn't seem to be from credit risk-weighted assets, so I was just wondering what the drivers of that -- what, and if there is any, if it's a one-off or it's more a driver of changes going forward?

David Paul Craig

I don't think it's actually either. There is a schedule at the back that gives you more detail, which I'll try and find -- yes, on Page 110, which gives you more detail of all of the ups and downs. It's -- there's always lots of movements. Foreign currency was one of the impacts this particular time, but trade and market risk went up 3 basis points off risk up 4. Lots of things in there, and some regulatory reinterpretations that net went up 12 or so. So there's lots and lots of things in there but no particular pattern. Nor, would I'd say, any particular trend at this stage.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. I think, Ian, you just mentioned that bright people predicting where the cash where they're going to go. I noticed your economist have the full costing flat at around 2% over the next 3 years. Just looking more closely at your interest rate risk on your banking book movements for the period, so I think you're a long way down to about a bit under $5 billion of risk-weighted there, down from sort of 15 to 18 over the previous couple of halves. So what do we read from this? Is it a view that under a lower rate environment, it's difficult to make money? No further cash rate cuts expected? Is it a preservation of capital exercise? Can you enlighten us, please?

Ian Mark Narev
Former Executive

Yes. If you have a look on Page 109 at the pack, you'll see a breakup of the details of the interest rate risk in the banking book. So you can see 2 significant drivers. One is that the embedded gains that we've been made on that, primarily from falling interest rates, have actually increased, and so that reduces -- that's an offset against interest rate risk in the banking book, so reduces the capital claw [ph] because we have all of this unrealized gains sitting in there. And the second piece is the repricing yield risk, which, again, is a reflection of low interest rates and the view we've taken on the [indiscernible]. So those 2 factors have seen a decline in this particular period.

Warwick Bryan
Former Investor Relations Contact

Richard? Mr. Wiles?

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles, Morgan Stanley. A couple of questions on capital, David. At the last result, your common equity Tier 1 ratio on an APRA basis was pretty much in line with where it is today, and yet you chose to neutralize the DRP. Could you let us know why you're not doing that this time around? And secondly, there's some moves offshore towards requiring all banks to use standardized measures of risk weighting rather than advanced measures, or at least inputting some sort of risk weight floor on the IRB measure versus standard measure. Can you give us some indication of where your common equity Tier 1 ratio would be if you use standard measures?

David Paul Craig

So let me try and take those 2. Firstly, just starting with the neutralization question. And look, this is a -- as I think you know, this is a call we make each and every time based on trends, and we're looking particularly at growth. Obviously, as you can see from this one, the volume growth in our book, the 7% growth was the main downward pressure on capital this time. In other words, we're growing the business, and so we need a bit more capital. So as we look forward, each time in making a judgment, we look at what we think might happen on growth to make sure that we absolutely can cover whatever our customers need and trends and movements and so on. And so taking all of those things into account, this time, the board has elected not to neutralize this particular dividend. But we will look at each and every dividend and make a decision each time. But we're very comfortable with the level of capital we have right now at 9.2%. I think we have the highest capital of any of the major banks in Australia and clearly, an unquestionably strong capital on any global measure. So we're very comfortable with that level of capital and I think it's just more a function of growth in the business. On the question of all of the different noises that are being made internationally and locally, obviously, we have a financial systems inquiry under way -- well, not under way, but they've reported and we still don't know what will come out of that. And then, in particular, there's a lot of reviews of lots of different factors on capital internationally. So as I sit here today, the outlook for exactly what the rules will be in 3 years' time is probably less certain today than it was, say, 6 months ago because of all these international reviews. So we are -- inputting, we're actively involved in the discussions both locally and internationally on all of that, and we'll watch and make sure that there's a sensible outcome. We're not going to enter into -- I mean, there's so many different moving parts in the capital, Rich, that I don't think it will be useful to sort of talk about standardized versus not on any one particular part of the portfolio. I think it's very important though to remember that the Australian banks already carry more capital against mortgages than almost any other regime around the world. So with our 20% minimum LTD, for example, we are already very, very conservatively capitalized on a home loan basis.

Warwick Bryan
Former Investor Relations Contact

Mike Wiblin at the back, and then I'll go to the phone, I think, and come back to the room after that.

Michael Wiblin
Macquarie Research

Mike Wiblin from Macquarie. Just talking a little bit more about macro potential, you sort of hinted at it, Ian, what do you think from here will be the impact of that policy from APRA and the RBA on the bank but also on the system? Can you talk about that a little bit?

Ian Mark Narev
Former Executive

I mean, we're talking about a couple of different things here. In terms of monetary policy, I think we probably covered that. The RBA had its reasons to wanting to cut the way in which they're placed to different parts of the businesses. I think you're all pretty familiar with. In terms of the broader issue about house prices, APRA's concerns about home lending, et cetera, APRA is doing exactly what a good regulator ought to be doing in the kind of environments that we were talking about before, which is making sure that they can satisfy themselves that bank boards and bank managements are lending prudently on a through-the-cycle basis and not getting over exuberant in a low interest rate environment. What I can constantly say is that when we speak to APRA about their expectations and we see how that lines up with our own risk appetite is very good alignment. So a -- in the range of most likely foreseeable tools that either APRA or the reserve bank might use, we don't see a really significant impact on our business because it's pretty much how we're operating already.

Michael Wiblin
Macquarie Research

And just second question, on Page 13 of the 4D, it seems to be a bit of a shift on the expense versus the capitalized investment spend. Can you just talk a little bit about what's driving that? Is that investment in certain software assets? Or -- and is that a trend that we should expect to continue?

Ian Mark Narev
Former Executive

No change in the capitalization policy. I mean, what we have seen for quite some time is despite the fact that we've made these really significant investments, particularly in the core platform, the reason we still got the lowest capitalized software of all the major banks despite that investment is because we've tended to put more through the P&L. The fact that there's a little bit more in this period that's gone through capitalized doesn't reflect any change of policy. It just reflects the fact that the source of investments that we did in this period were disproportionately more towards things that could be capitalized and amortized down over time. No change of any sort of strategic or accounting significance.

Warwick Bryan
Former Investor Relations Contact

I'll now go to the phones, Brian Johnson. Can you hear me, Brian?

Brian D. Johnson
CLSA Limited, Research Division

Yes, I am. Just 2 questions very quickly and they're mechanical. If we have a look at the committed liquidity facility, Slide 53, what is the lowest level that you would tolerate the year practically running it down? Or at what point would it become physically a constrain on lending growth?

David Paul Craig

Well, it's not -- we're not going to let it run down. I mean, it's not a concern on lending growth, Brian, because clearly, we will always make sure that -- you're talking about the actual facility or you're talking about the liquid assets?

Brian D. Johnson
CLSA Limited, Research Division

Oh, I'm talking about -- would you let it -- during the year, would you let it decline from 115% down to 100%? Or would you practically let it only decline to like 105%?

David Paul Craig

Well, we're not -- I'm not going to go in -- we clearly have internal limits. We would never let it get below 100%. That's the bottom line. Clearly, we have a requirement to do that, and we will always manage conservatively.

Brian D. Johnson
CLSA Limited, Research Division

I don't think APRA would let you, David?

David Paul Craig

Oh, good. Thank you. Well, then, you and I and APRA are all in agreement. So that's good. So -- but we're not going to -- clearly, we hold liquids according to what we think the market needs at a particular point in time, taking into account both growth forecasts, our view on the market, all sorts of things at a point in time. You've seen our liquid assets move around. We'll always make sure though that we're at the conservative end of judgment on that, but it won't be a restraint on lending.

Brian D. Johnson
CLSA Limited, Research Division

Okay. And the next 2 are very, very mechanical as well. Slide 45, how much of the overlay is actually the discretionary economic overlay in the collective provision as opposed to the component that's modeling our granularity?

David Paul Craig

As you know, Brian, we don't disclose that.

Brian D. Johnson
CLSA Limited, Research Division

Okay. Well, then, I'll push my luck. Just on the home loan stress test, Slide 101, can you just confirm that your serviceability buffer is 150 basis points? Am I misreading that?

Ian Mark Narev
Former Executive

No. You're not misreading it.

Brian D. Johnson
CLSA Limited, Research Division

Does that seems a little bit light?

Ian Mark Narev
Former Executive

We'll hand over to Alden. He -- we'll give him the mic, so you can hear him. But he can give you the chapter and verse on exactly how that works.

Alden Louis Toevs
Former Group Chief Risk Officer

Brian, thanks for the question. The -- in addition to the 150 basis points, there are other requirements on serviceability tests that are not demarking exactly in that same way. There's an amount of bona fide savings and other things. If you put all the other increments that we impose together, it's well north of 150 basis points. And if you take a sort of a sample of applicants for loans and sort of test against how much we would lend versus others in the market, you would find us on the conservative end of the serviceability principle that we would lend -- serviceability-based principle that we would lend. So we're on the conservative side to the industry.

Brian D. Johnson
CLSA Limited, Research Division

And Alden, what made the stress test loss actually increase over the half?

Alden Louis Toevs
Former Group Chief Risk Officer

It decreased over the half by about 10%, and that was largely driven by -- there's all kinds of things, the growth and so forth. But one of the component parts, there's the growth affect offset by some house price appreciation, which gives you an extra cushion.

Ian Mark Narev
Former Executive

So the stress test is on Page 104, Brian.

Brian D. Johnson
CLSA Limited, Research Division

Yes. And if I go back to Slide 102 of the last result, the stress test loss was $1.16 for the uninsured mortgage portfolio over 3 years. And I think in the slide today, it's $1.9.

Ian Mark Narev
Former Executive

Fiona?

Fiona Larnach

So the equivalent...

Alden Louis Toevs
Former Group Chief Risk Officer

Sorry, give her a microphone.

Warwick Bryan
Former Investor Relations Contact

We'll just give you Fiona Larnach, the Retail Chief Risk Officer, Brian. She can tell you.

Fiona Larnach

So on a like-for-like basis, Brian, that number has gone down. What we've shown here, this schedule has more information on it than last time we disclosed. So on the left-hand side, you can see a number of 3.1, which is our total losses. Previously, we were disclosing the amount net of any Genworth-insured losses. So we've given you now the full amount, the Genworth component, if you like, with insured and then the net number. So on an apples-to-apples basis, the number's gone down, and you can also see in the last bullet point, we've given you the total reduction, which is in line with what Alden just said, 10%.

Brian D. Johnson
CLSA Limited, Research Division

I'm looking at the slide last time, it's not what it says but anyway...

Warwick Bryan
Former Investor Relations Contact

Brian, yes, I think that's 4 questions. Brian, if you want some more, come back later. We'll go back to the room. Any more questions in the room? Brett?

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

Brett Le Mesurier from BBY. The Institutional Banking & Markets division continues to be the lowest-returning division. Are you going to limit the growth in that division to below the company average?

Ian Mark Narev
Former Executive

Well, we're obviously happy with the growth that's happening there. I mean, the combination of these are the balance sheet, the foreign exchange, commodities, interest rates, business [indiscernible] to the transaction banking is pretty positive for Commonwealth Bank's shareholders. So we've often had the question about when you look at all that, is it plus or minus the group average of 18.6%? The point for us is that in the way that the strategy is being managed, it's creating really good returns for the Commonwealth Bank's shareholders, and we're happy to keep investing behind it. I mean, the likelihood that gets so big that it's going to create a material difference, the group ROE, I think we are a number of periods away from having to discuss that likely outcome.

Warwick Bryan
Former Investor Relations Contact

Do we have any more questions? Well, that must be -- oh, there we go. Catherine [ph]?

Unknown Analyst

Just interested in terms of the mortgage book, with the strategy around broking, the broking strategy, because that's obviously underweight where the market is at the moment. And then also in terms of investor housing, you said the 10% limit and you're happy with that. So should we just assume you'll be going just below that or [indiscernible]?

Ian Mark Narev
Former Executive

Yes. I mean, I might get Matt to comment in a bit -- in a second. I mean, there are all sorts of different parts of the channels. Our proprietary channel is going really well. We've got investment. We really like in Aussie home loans. We've got the presence in the broker channel. We've got an appetite to be in all those different channels. In terms of our appetite for the mix, it depends a bit on where the flows are coming in the market, but I might get Matt to talk a little bit about that.

Matthew Comyn
CEO, MD & Executive Director

Sure. Yes, I mean, we deliberately the [indiscernible] is dependent on the broker channel relative to our peers. And obviously, the broker channel has been growing faster than proprietary, which is something we watch very closely. We haven't participated to the same extent either in the broker channel and particularly in the investor, primarily in New South Wales and Victoria. Number of different reasons, one of which is there's much greater price sensitivity and in investor, and so we're very focused on the divisional and even managing volume margin tradeoff. So that's been sort of the real drivers of that included in the -- our broker disclosures as well as the Aussie relationship, including the Aussie white labels. So we have a white labeling arrangement with Aussie home loans as well so we're looking to basically deliver consistent growth. Heavily focused on proprietary broker will always be an important part of our business, but we are focusing primarily on our proprietary channel.

Warwick Bryan
Former Investor Relations Contact

Richard? Oh, sorry, let me just -- can I just go to the phones first? Scott Manning from JPMorgan. Can you hear me, Scott?

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Yes. Just wondering if you could talk us through the outlook for impairments more broadly, given the fall in resource prices? Obviously, no immediate impacts but just how you're thinking about the roll-through of hedging, covenants, risk assessment, whether there's a risk that we do see an uptick there in coming periods, if commodity prices stay where they are?

Ian Mark Narev
Former Executive

I'll get Alden to provide a bit of color in a second. But the fundamental issue, and it's exactly as we've talked about with the serviceability in the home loans, is that in an environment that we're in at the moment, we've got to make sure that the assumptions on which we're doing our lending, particularly on oil prices, reflect likely stresses in the market. So when we're looking at, for example, our position with big players who are depending on the oil price, we're looking at price of $30 a barrel. Those sorts of assumptions mean that we have a pretty high degree of comfort in the quality of the lending that we're doing. However, always an environment where there's some degree of systemic deterioration, you're going to see a little bit of a that flow-through into the lending book, and I said earlier that although we have a

17-basis-point increase in the IB&M LIE, up to 22, that's still below where would expect it to be through the cycle. So as with the rest of the book, that's just suggests to us, it's probably a little bit more risk to the downside. But Alden, you might want to add to that.

Alden Louis Toevs
Former Group Chief Risk Officer

Clearly, this portfolio has attracted some attention. We model and look at the vulnerability of our portfolio to commodity price changes across all the mining, including oil and gas. 80% to 85% of our lending is to investment grade. A lot of these, and the dominant part of our portfolio has a very low cost to extract, and we have long-term service contracts on the disposition protecting us, plus we have some subordinated capital and other protections ahead of us in terms of a capital loss. So there could be some downgrades. I think the downgrades will be modest in terms of the provisioning impact that could happen. We see sustainability to low commodity prices across the portfolio, and it's well tested.

Warwick Bryan
Former Investor Relations Contact

James?

Andrew Triggs
Deutsche Bank AG, Research Division

Andrew Triggs from Deutsche Bank. Just a question on cost, if I could. Very strong performance obviously from both the Retail Bank and Bankwest and obviously a very low cost-to-income ratio now in RBS. Where do you think you are on your productivity programs? Can you maintain the momentum there? And how much of it, I guess, [indiscernible]? And does it get a bit harder from here?

Ian Mark Narev
Former Executive

Look, a couple of years ago, we were asked are we going to hit the 35% cost-to-income ratio, and at that stage, we said we're not going to hit the target we were told, although that probably means you're walking away from it, and here were are at 34.5%. In the nature of these productivity programs, if the business is being managed well, each incremental productivity is obviously a little bit harder than the one before it. That said, we're in an environment where my firm expectations of all of the group executives running the businesses is that they can continue to grow revenue faster than expenses in pretty much any foreseeable environment. If we succeed in doing that, which I think we ought to, we should see the cost-to-income ratio to continue to go down. Now I'd reiterate what I said in the past, which is it's a poor way to manage a business that for every 6 months is an unforeseen event you make stupid decisions just to protect the jaws. But honestly, as we look at it today, we're not anywhere near that issue. We just got to keep the focus on customer for the top line and keep the discipline on productivity, and I don't think you'll hear from any of my team they think they're anywhere near the end of that, whether they're running businesses or support functions.

Warwick Bryan
Former Investor Relations Contact

Rich, and then I'll go back to the phone.

Richard E. Wiles
Morgan Stanley, Research Division

Rich Wiles, Morgan Stanley. Slide 49 shows that the margin across your corporate division was flat in the half, which is a very pleasant surprise, given recent trends. Can you give us some more color as to what drove that flat outcome? What was better than in the previous half?

Ian Mark Narev
Former Executive

It was a combination of different things. In the Institutional Banking & Markets business, there's no doubt that given the proliferation of international players in the market, the margin pressure in that area is a little bit downward. And it's just a function of the market that we're in, and I don't expect that to change any time soon. In the business bank, there has been really good investment in technology innovation, and off the back of some of the things that we're doing with the transaction accounts with Comm business, it's enabling us to have conversations with customers about the whole range of needs in addition to doing a bit of product innovation. Now that sounds like it's sort of nirvana la-la land, which is you have this broader relationship, and you're able to do good lending at a better margin. But that's actually what the business is doing at the moment. However, these, in both cases, are very competitive environments, and so although we manage margin carefully, we all got to expect that the competitive pressure is really going one way.

Warwick Bryan
Former Investor Relations Contact

Thank. I'll now go to the phones. Brian, you're on again.

Brian D. Johnson
CLSA Limited, Research Division

Yes. I just had a question on Slide 15, which [indiscernible] a fantastic job, the one showing the customers versus the age group. Is your long-term strategy to get that line flat? Do you reckon you can actually get it flat?

Ian Mark Narev
Former Executive

I'm sure I hope that one day, either my successor or his or her successor will be here with that chart flat, about flat at the 45.8 level, not on the 26.5 level. But it's a good question. What we said last time is that it's been an endemic problem for the Commonwealth Bank as long as any of us had been here and well before that this extremely strong school banking in the youth presence has fallen away at the time that people are getting their first job, going to university, et cetera. And what we have felt has changed now against what people have been trying to do for a long period of time is the fact that the customer-driven functionality from our technology appeals directly to that customer segment more than others. And so what we explicitly expect from our strategy is that those parts, we're going to see less of a fall -- such a dramatic fall off from that really strong youth and school banking presence, and that's something, which, particularly, in Matt Comyn's area, we're really focused on. I'd like to think that, that yellow is going to continue to go up. But as I said to David a couple of days ago, we've now created a [indiscernible] bank by putting that chart, and so we're just going to have to make sure we keep it looking as good as it can.

Warwick Bryan
Former Investor Relations Contact

Thanks, Brian. Any more questions from the room? Well, if there aren't, I think -- thank you very much.

Ian Mark Narev
Former Executive

Could I just say this is Warwick Bryan's 20th and last profit announcement. I'm the third Chief Executive he has made look good, and all of you have [indiscernible] know this guy is just gold. I won't embarrass him by telling you why we think that he has just been a terrific service to the shareholders and the board, the management of the Commonwealth Bank team. And I think 90% of the time a delight for all you people to deal with and the other 10% of the time, he's been in the right. And he's -- and the ultimate mark of what he's done is he's groomed a terrific successor in Mel [ph] to take over. So I -- in this room of all your friends and admirers, I just want to acknowledge that. Thank you, Warwick.

Warwick Bryan
Former Investor Relations Contact
Thank you.