Question and Answer

Melanie Kirk
Head of Investor Relations

Great. Thank you, Matt. For this briefing, we'll be taking questions from analysts and investors. We'll be starting in the room and then we'll move to the phones. To ensure everyone can hear you, please wait for the microphone, state your name and the organization you represent. And to give everyone an opportunity, please limit your question to no more than 2 questions. We'll take the first question from Jon.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. With the NIM, you called out a number of moving parts. But one you didn't really mention was during the period, the July and October rate cut, you held on to the mortgage rate reductions for a period of about 3 weeks on each occasion. So your funding costs, a lot of your deposit costs fell, but you actually got an elevated NIM for 6 of the 26 weeks in that period. Can you tell us how much that elevated NIM for almost, what's that, almost a 1/5 of a period, helped your margin during the period? And going forward, do you think it's appropriate that you hold on to mortgage rate cuts for a period of 3 weeks? Given your technology investment, I'm sure you can change rates a bit faster than that. Do you think you can, in future, commit to passing rate cuts on by the RBA faster to your customer base?

Matthew Comyn
CEO, MD & Executive Director

Yes, look, Jon, let me start, and if Alan wants to add anything more specific. I mean you're quite right in the context of when there are rate changes and the timing of those rate changes. From our perspective, the time frame that we applied there is consistent with the rate changes that we've made in the past. And I accept the question about whether it could be done with greater speed and urgency. It is also given there have been a number of problems in and around fee and interest accuracy, it's a large-scale of technology change as well. So we want to make sure we do that with quality.

And so we've tried to keep a very consistent sort of time frame. In previous instances where rates have actually been going up, we've given customers extensive notice. So there is some benefit. I think Alan sort of alluded to that. And you're right, in the period, there is some benefit, of course, from both the pricing changes and the timing of those.

Jonathan Mott
UBS Investment Bank, Research Division

So will you be able to do that faster going forward?

Matthew Comyn
CEO, MD & Executive Director

Well, Jon, I think it's one of those things that we'll continue to monitor on an ongoing basis.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Richard.

Richard E. Wiles
Morgan Stanley, Research Division

Rich Wiles, Morgan Stanley. A couple of questions. Firstly, on expenses. You're clearly doing more on the cost savings. Good progress this year versus last year. But your costs are still growing around 3% per annum. So what's happening with your ambition to lower the absolute cost base, is that a realistic target? And when could we expect that to actually happen?

Second question is on capital. Even if you exclude the pending proceeds from insurance, you got about a $5 billion excess above your 10.5% target. Is an off-market buyback the most likely form of capital management given that it distributes franking credits and it lowers the share count, which are 2 of the things you've flagged as important for your shareholders?

Matthew Comyn
CEO, MD & Executive Director

Sure. So look, on cost, I would say, better progress, but clearly a lot more to do and increasing momentum and that will continue to be a focus for us going forward. In terms of our aspiration, it's unchanged. I mean it's literally 12 months ago since we talked about that. And I remember the day after we said that sub 40% cost to income, the RBA neutralized the rate stance and we had 3 rate cuts, which -- so I see the perils of providing guidance specifically, but we recognize that that's such as life. So I feel like we've -- it's still realistic. It's clearly more challenging than it was 12 months ago. I mean ultimately, we're going to make the best decisions that we can for the long term of the group.

I realize it's not particularly helpful, but we still say that's a medium-term objective. What you should expect from us and what we're certainly going to intend to deliver is increasing momentum in that particular expense reductions. We meet, as a management team, on a weekly basis. It's a huge focus. There's obviously a number of other things that we're working on and we need to get better at it, at least at this -- for this period, it was better than it has been in prior periods.

On capital, clearly, I'm not going to sort of foreshadow either size or particular type. But I mean what we tried to do -- and feel free to add in, Alan, provide additional disclosure in terms of the way we're thinking about unquestionably strong. It enables obviously you to be able to try and calculate what you think that level of surplus capital would be plus there's future divestments that are coming. We've said obviously the Board is actively considering that. And one of those considerations is we have surplus franking credits. And so we provide additional disclosure, both at the size of the surplus franking credits and the franking credits for tax purposes as well. So there's not really much more we can say at this point in time. But I think it probably is hopefully helpful in the context of you be able to calculate it.

Alan Docherty
Chief Financial Officer

Yes. I mean an immediate focus from a capital management perspective is this neutralization of the DRP. So that's going to involve an on-market share buyback during February and March. So that's sort of a near-term focus. We've also flagged that we're expecting to receive some further divestment proceeds during the third quarter of this financial year. So in the near term, that's our focus. And as Matt says, the Board will continue to consider the future of capital management...

Richard E. Wiles
Morgan Stanley, Research Division

The $500 million of DRP neutralization, I mean it's small being compared with the $5 billion of excess that you've got. And just to be clear, you've clarified today that the target is 10.5%. You don't think you need to run with a buffer above that?

Matthew Comyn
CEO, MD & Executive Director

I think what Alan...

Richard E. Wiles
Morgan Stanley, Research Division

My math sounds correct, isn't it? $5 billion of surplus above 10.5%?

Matthew Comyn
CEO, MD & Executive Director

You could calculate it. It's a relatively easy calculation. I mean what Alan said is that we're going to run about 10.5% for the majority of the year. So that's at least 7 months. So you can then sort of calculate how far above that is across the -- across the period. And when the timing and the size, yes, $500 million is the context of the number that you're putting forward, but that's what's immediately ahead of us. And so over that sort of mid-February into March, we'll be on market purchasing shares. But at this stage, it's under active consideration. And certainly, the flexibility that we've got enables us to think about that in the near term.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Jarrod.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Can we just go back to the margin slide, a bit of clarification. If I take in the blue box in the top right-hand corner, the second half margin down 5 basis points, that sort of implies [2.06] But then if I use the second line in that with full year '20 margin down 4 basis points, that implies [2.06] for the full year, which implies a second half margin below [2.06]. So there seems to be a disconnect between what you're saying around second half using either the top line or the second line.

Alan Docherty
Chief Financial Officer

No, no. So what I'm providing there is the flow-on effect of the previous financed cash rate reductions, including the lower swap rates and the impact that has on the unwind of our replicating portfolio and equity hedges. I'm not trying to predict an absolute net interest margin number between periods. It's the flow-on effect and how that unwinds between 1 half and a financial year.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Victor.

Victor German
Macquarie Research

Victor German from Macquarie Bank. Matt, if I were just able to follow-on from your comment around noninterest income that you feel like you've reached the floor and you can grow from here. And I appreciate, thank you for all the disclosure you've provided. Just be interested in perhaps a little bit further color in terms of why you think that's the case. I appreciate that you've obviously done a lot of rebasing. But there's still presumably underlying pressure in that line item. And I know you have quite good disclosures showing deposit fees, but you still have about $400 million per year contribution. Just interested in sustainability of that.

And then second question, it's quite unusual for one of the major banks to sustainably deliver superior growth in mortgages relative to 3 other peers. But just interesting in your observation as to why do you think you're able to do that and how sustainable is that?

Matthew Comyn
CEO, MD & Executive Director

Sure. Yes, I mean in the noninterest income line, I said modest growth. Obviously, that's right. And of course, that considers all things being equal. So it's not to say that there won't be changes in the competitive context, et cetera. But in the work that we did last year, we sort of looked top to bottom across our business and made some decisions about what products we no longer offer, how we want to charge for those. We introduced a number of alerting features to help our customers understand what they're being charged and when, which had a direct impact. We forecast at that time that $275 million would grow to $415 million. We've seen that flow through. And we feel like there's some modest growth opportunities which is really just a function of growth from here.

Of course, as you go over into the medium and long term, is there potentially downward pressure on interchange rates? Are there potentially downward pressure on other fee types? Absolutely. But we would consider, at least from what we can see. We believe there's still modest opportunities from here.

And to your second question, yes, look, I mean given our size, you're right, it's unusual. We have not seen it before since sort of GFC. It surprised us that it persisted. I can't speak for all of the other institutions. I feel we've had a good start to the year. So I feel good about January and February, but we wouldn't expect our system performance or our volume performance in home lending to persist at these levels.

And I think the main driver -- sorry, to come back to the other part of your question has really been -- we've been very consistent around operational execution and turnaround times. And obviously, one of the other competitors gave a briefing yesterday. Similarly, we've seen they've done a very good job around operational execution. And there's been obviously greater variance in the market. And so those that have been consistent, in particular, have been rewarded because others haven't. So particularly in the broker market, that's where flow has shifted between institutions, which is always the case, brokers will move to institutions where they know they can get a speed to decision in same day or within 48 hours versus perhaps waiting much longer than that.

Victor German
Macquarie Research

Sorry, just one thing on that. I mean some of your competitors mentioned that perhaps you haven't implemented some of the changes and been delayed on that. Are you able to just confirm that that's not the case, and you've implemented everything that you needed to implement into the processing?

Matthew Comyn
CEO, MD & Executive Director

Yes, that's not the case. Yes, I've heard those suggestions and that's not right.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Matt Wilson.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

Matt Wilson, Evans & Partners. You talked about the front book/back book issue in your mortgage book. Can you add some color to the inertia rents that exist in your deposit book?

And then secondly, you've gone from spending $750 million a year on productivity and growth initiatives to now only $300 million a year. Yet you aspire to maintain your technology edge, et cetera. And then can you talk about the issues that have constrained the investment there?

Matthew Comyn
CEO, MD & Executive Director

Yes. I think -- why don't I come back to deposits or maybe, Alan, if you want to take it? I mean on the productivity and tech side, Matt, I think it's a really important question. The way we think about it, of that $1.3 billion, basically $1 billion of that is tech spend. We've got 5,500 people working on projects. Clearly, we would like more of them against productivity and growth. We've had a big regulatory agenda. I mean financial crime is a good example. We've got more than 1,000 people across our financial crimes team. We're probably spending $200 million circa cash investment in that area. As one of the points that I was trying to make is that, yes, absolutely, we see that as regulatory and compliance.

And when we deem something as regulatory and compliance, it also triggers a slightly different accounting treatment. We'll expense a much greater proportion of that over a shorter time frame. But we've also --

the way we're sort of trying to pivot that spend is making sure that we're building sustainable assets which don't just deliver benefits in the context of, say, financial crime per se, but also have additional benefits in the context of having high-quality at source information, which you can flow through at the organization reliably and reconcile is valuable. Absolutely, what I like to be. Once we've got to the level of management of nonfinancial risk that we think we should be delivering, move more of that investment into productivity and growth. Absolutely.

And the second part of that equation is, would we be prepared to invest more into our technology because we sit it at the heart of our competitive advantage. Yes, we would. The binding constraint for us at the moment isn't so much trying to constrain the financial envelope. It's all about actually access to high-quality resources and even on the portfolio that we've got at the moment. We feel like we're not executing optimally, and we want to make sure that for every dollar that we're spending that we're getting a good and efficient return on that. And so to the extent that we're -- obviously, we're working hard on strengthening that. We feel like there's good opportunity to scale that, then we'd be prepared to do that.

Yes. You want to talk on the deposits?

Alan Docherty
Chief Financial Officer

Yes. Sure. So on deposits, obviously we called out during the time of the last cash rate reduction, it was around $160 billion of deposits that we couldn't reprice due to the low levels of interest rates. I mean one of the interesting things, though, that you've seen in this result is given the really strong growth in both transaction and savings deposits, you've seen a substitution effect between term deposits which is obviously higher yielding and lower margin and lower-yielding and higher-margin transaction and savings accounts as customers increasingly value the convenience and functionality of the transaction at-call online accounts.

And so that's one of the reasons our net interest margins held up pretty well over the past 6 months. So it substituted both more expensive or less expensive forms of deposit funding. It's also allowed us to retire some expensive wholesale funding during the period. And so yes, deposit pricing is going to continue to be an issue in a lower rate environment, where we're seeing some pleasing momentum in underlying customer deposit growth.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

I actually didn't mean that they're in the deposit book, there would be instances where your back booking deposits are earning much less than what the current rate would be if they're new-to-bank customer today. And this is something the FCA is currently investigating in the U.K. Given the nature of our policy development, we'll probably copy them. Can you comment on that one?

Matthew Comyn
CEO, MD & Executive Director

Yes. Look, I understand your question, Matt. Look, I think one of the issues for banking as it is for every other industry is, to what extent is it acceptable to have promotional offers, rates to attract new customers. In any highly competitive market and industry, competitors will compete for new customers. Now that has to be done in a way which isn't unfair to existing customers and, of course, doesn't -- you come up with second-order effects.

I think in deposits, there's certainly been less attention on that as an issue. And hence, why I focus more today in and around home lending. That's another area that we look at. It's probably, I think, overall, at an industry level, it's probably reduced. There's a relatively small number of products where there's a pricing construct that's quite different.

And yes, you're right. Any of those regulatory environments, we watch closely. There will be a focus in a number of these areas. But I think it's much around awareness. As there is a focus around sort of vulnerability of customers. We've got a lot of work underway there. And so we try to, as best we can, understand and get ahead of those sorts of trends.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Andrew Triggs.

Andrew Triggs
JP Morgan Chase & Co, Research Division

Andrew Triggs from JPMorgan. Just to follow-on from your comment there, Alan, on the substitution effect. But do you say this as a long life NIM tailwind on the coming halves, or is it sort of mostly being penetrated in this half?

And the follow-up question just on term deposit pricing. From what we can see, it hasn't led to a lot of pulling down of rates in the term deposit market. Is that something that you would naturally expect to follow later on?

Alan Docherty
Chief Financial Officer

Yes. I mean if you have a look at the average balance sheet disclosure, you'll see the fall effect and the net interest margins during the current half. And so yes, I'm not viewing it as a tailwind in the future period. We did well in the current half on that basis. And sorry, your second question?

Andrew Triggs
JP Morgan Chase & Co, Research Division

Just whether that substitute effect then leads to better spreads on term deposits for the bank? As in there's less money chasing term deposits? Can you pull those lower?

Matthew Comyn
CEO, MD & Executive Director

Yes, I think what we've seen is that -- particularly, if you look at just TD pricing, last year, when rates move, the yield curve moved, that put a lot of pressure on TD margins. They really contracted. I think you've seen as a function of that, our TD prices moved down over the course of calendar 2019. The customer forum that I had in Brisbane, it would have been, 70% of the customers there were asking about their TD pricing, not their home loan pricing. So I think for customers out there, they're really -- they're feeling the impacts of a low interest rate environment quite sharply. So I think we're very conscious of that. If you look at sort of TD pricing, it's come down quite substantially across the market as you would expect it too, given rates. Not a little bit of substitution out of TDs, not much, though, in terms of our customers chasing other sort of high-yielding investments, equities, et cetera, maybe at the margin a little bit of that. Probably less mix shifting between transactions and savings accounts, given a low-rate environment, probably overall helps the transaction balance growth.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Andrew Lyons.

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Andrew Lyons from Goldman. Just 2 questions. Firstly, on your IB&M NIM was down 10 basis points in the half. I just wondered just how much of that related to portfolio optimization that you're doing within that division versus the broader competitive market?

And then secondly, you've also spoken about being relatively underweight in commercial banking and the business lending within your Business and Private Banking went backwards in the half. Could you perhaps just talk about strategies you have to rectify the market position and what the competitive environment looks like in that space?

Alan Docherty
Chief Financial Officer

Yes. In terms of the Institutional Banking margins, we've seen a couple of things in there. So firstly, the -- that lower earnings on our equity, we transmit that to each of the business units. So you see that manifest in the IB&M results. So that's certainly in there. We've also got a bit of switch of revenue between P&L line items in this period. So we've got lower yields on some of our commodities financing income, and that's offset by some stronger performance from a mark-to-market perspective that you see come through other banking income. So there's a -- you see a bit of a gross-up of a netting between net interest income and other bank, in particular, in this current period.

Matthew Comyn
CEO, MD & Executive Director

And in commercial lending, in particular, I mean nothing untoward. There's probably a higher level of runoff in the -- particularly in the last sort of couple of months. I think we would describe -- I mean our overall business lending is okay. Clearly, our aspiration would be slightly stronger performance there. I think it's a combination of, I think, we can improve our offering. I talked a bit about business express and just faster speed to decision, turnaround time, particularly for sort of sub-million dollar lines. There's a number of things that we are working on and we'll continue to. We've got a very good sort of customer base and deposit franchise in business lending. We've historically not been able to convert that into the commercial lending opportunities that would otherwise be there. Obviously, it's going to be a very competitive context in that particular area as well.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Brendan.

Brendan Sproules
Citigroup Inc, Research Division

It's Brendan Sproules from Citi. I just wanted to ask about your consumer finance revenue volumes and margin this particular period. Just the volumes have been falling for a number of periods. And obviously, you're now investing in Klarna, but you've also launched a debit card, which I mentioned somewhat competes with credit cards. So just the outlook for volumes, but also what sort of pricing initiatives that you take that revenue obviously grew even though volumes fall? And have you sort of included that in your forward-margin guidance when you talk about sort of announced repricing? Or is that something different?

Matthew Comyn
CEO, MD & Executive Director

Yes. So let me talk about consumer finance. You're quite right. I think it's one of the sort of softer areas of performance. And maybe I'll just talk about it in a couple of different ways. So I mean we look at cards business, and both have been strong contributors to profit and profit after capital. A number of different changes. I think there's a structural shift that continues away from credit to debit. I think buy now, pay later is an element of that. But frankly, that was underway before then.

A number of both regulatory changes in the -- domestically in the context of both no longer able to offer credit limit increases. We used to run, for example, our cards business, a pretty conservative line assignment. And credit limit worked very effectively, we think for both customers as well as overall returns. Obviously, changes around responsible lending, particularly the amount of repayment that you need to include in the application process. So there's a number of things have tightened, interchange has come down. So I think the proposition in Australia vis-à-vis other markets as cards actually aren't falling substantially in a market like the U.S., for example, they're much higher interchange.

So the Ultimate Awards card, we want to have a better product available for transactors. We think the structural shifts there in the context of debit over credit client is part of that. But there's, I think, more to it. And then on -- so I'd say there's demand and supply. And then on personal loans, more bias towards tightening, combination of both probably the regulatory settings, had similar application rates, but actually approval rate is quite well down.

One of the things that we're thinking about in the context of that is our overall pricing strategy as you would expect. And we see that as an area of real focus. It's been a real strength for the best part of a decade and in the last period. For a number of those different reasons, it has come together to be a soft point.

Alan Docherty
Chief Financial Officer

In terms of the margin implications of consumer finance, I mean one of the things you'll see as well, there's a mix shift within the credit card portfolio from growth in some of our newer low rate card products. And so that has, if you like, an offset with the mix of that consumer finance portfolio. So I wouldn't -- you wouldn't expect to see material margin tailwind from that.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Brian.

Brian D. Johnson
Jefferies LLC, Research Division

Brian Johnson, Jefferies. First is congratulations on the actual execution, which has probably got not much to do with where the share price is, but it's very noticeable. You're at executing your peers.

Two questions. The first one is that when we have looked right at the back Slide 127 and the following slides, there's a lot of stuff about share count and the value of franking credits. And also when I have a look at the NIM slide, I can see a fairly substantial NIM headwind coming forward. And that's not unreasonable to think that EPS and DPS is going to fall. The argument between maintaining the dividend versus off-market structured buybacks. I'd just be interested if we could just get an explanation of how you think about maintaining a dividend in the face of earnings falling and saying that the share count is going up versus basically reducing the share count by more by doing a bigger structured buyback. It kind of seems if you're running a private business as opposed to a public company in Australia, all that matters is dividend. I think you'd be opting for a buyback except the share price is too high. So I'd be interested if you could explore that.

And then the second one is an even more esoteric question. Slide 61, for the first time, I can recall, you've actually disclosed your cost of capital of 10%. Your ROE is sitting at 12.7%. If we were to go back last year, we saw an environment where basis risk rise -- rose and all the banks used this as an excuse to basically disenfranchise the back book housing by increasing the rate. Basically, as we saw basis risk improve. Basically, we didn't see any banks passing it back on. The central issue on Australian banks remains have you got the pricing power to keep on raising basically back book housing rates particularly now that you've told us your cost of capital is 10%, you're doing an ROE of 12.5%. I'm just wondering -- I'd like to get a feel how those dynamics play out.

Matthew Comyn
CEO, MD & Executive Director

Why don't I take a stab at both of those, Brian, and I'll throw to Alan. Maybe the second one first. Yes, cost of capital, a number of people, I think, particularly, you, have been asking for that for a while. So we decided to include it. I think it has more of an impact, frankly, in our businesses like institutional, where obviously there's pricing. And we've elected to keep it above the way we would calculate our cost of capital at this point in time because we want to drive. And I think Andrew is doing an excellent job of having a lot of discipline there. I don't really want to speculate too much about sort of pricing power, particularly as it relates to home lending. It doesn't have a huge impact in the sort of day-to-day management of -- to other businesses. In context of price settings, that's an area of huge focus for us in terms of making the best decisions for our customers and for the long term.

Then maybe going back to the first part of your question. Yes, look, that disclosure towards the back of the slides. I mean clearly, management of the share count has created value in the context of CBA. We're very conscious of that. But I guess to go to your broader question, how do we think about the context of potential capital management, dividend, dividend sustainability. I mean between the management team and RMC have this regular discussion with the Board. We sort of think about over multiple years of projection. What level of credit growth are we assuming. What do we expect happening with net interest margin.

You're right, you're quite right, we assume base case, interest rates are going to stay low for a long period of time. We've got a big headwind that's coming. But we feel that there's a number of things that we can still manage within that, including our expense line. We think a lot about the organic capital generation. Some of that's our business mix and our settings. That's one of the strengths that I think of this result of 37 basis points, notwithstanding a high payout ratio. It's a very good organic capital generation. That's one of the reasons why our share count has been able to remain low.

So we factored that all into the way we think about potentially capital management as well as the dividend decision each 6 months. And based on all the information that we have in front of us today, we feel very comfortable that the appropriate decision has been made. I think Alan sort of set out some of those considerations. If at any point, and yes, absolutely, it wouldn't be an insignificant move to reduce the dividend for the Commonwealth Bank given the broad retail shareholder base. But if at any point in the future, we felt that it was in the best interest of the organization, then we would do it. And the other factors I'd like to add in would be obviously credit outlook, movement, risk-weighted assets, et cetera. So we've sort of done that modeling, as you would expect, going out multiple years and tried to consider all of those factors.

Alan Docherty
Chief Financial Officer

Yes, I mean in the additional disclosures, Brian, what we're really trying to do is give people a sense that we're very focused on earnings per share and dividend per share, there is both a numerator and earnings component to that. It was also a denominator and share count component to that. That goes to the capital intensity of your earnings and how much franchise capital generation you can provide subject to a certain level of payout ratios. So it's more to get a sense that we're very focused on both aspects of earnings per share and dividend per share.

Melanie Kirk
Head of Investor Relations
Great. Thank you very much to everyone for joining. That brings to the end of our briefing. If you have any follow-up, please come back to the Investor Relations team. Thank you.