Question and Answer

Andrew Bowden
Head of Investor Relations

Okay. Susan, just bring it down the front here, please. Come down the aisle. Thanks. Just one moment. Jarrod, do you want to go now?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. If I look at your considerations for FY '18 and, in particular, dot points 2, 3 and 4, if I read those in aggregate, I'd read out of that, that the revenue outlook is softer in FY '18 versus FY '17. In aggregate, just reading through those comments, it's lower lending growth, margin starting high, but you got principal and interests switching coming along and headwinds from transaction fees. Now so correct me if I'm wrong, if that's not the correct reading of the revenue side of things, by then you've got your expense expectations, which pretty much the same as last year. So question is, considering revenue growth does look a bit softer than it was last year, why are you targeting the same sort of expense outcome? And not wanting you to necessarily get angry on costs, but to what extent do you have the ability to pull the lever a bit harder on the costs? Is there some bulge of costs that you've got to get through before you get those productivity savings? So just a few comments on that if you can.

Brian Charles Hartzer
MD, Group CEO & Director

I might start with the costs one, and then maybe you can talk a bit about the revenue side. We reset the bar on our approach to productivity 3 years ago, and remember, we lifted our investment by $300 million, and we set that goal about keeping costs growth down to 2% to 3% and driving towards the 40% cost-to-income ratio. And we're essentially on track with that. And what that allows us to do is keep going after the structural drivers of costs, and I referred to one example of that, which is the 2 platforms that we need to consolidate. We got a huge amount of other work going on around simplifying the organization, reducing the number of products and the like, and that's continuing. And we are getting more and more detailed in understanding where those costs are going to come out, but we're not doing a knee-jerk reaction. I know it's people like big announcements, but the reality is that we've continued to drive this out at a steady pace, and over time, we think that more and more of that will come out. We do have some flexibility, though, on the pace of investment. You saw that this year, where, essentially, if we hadn't continued to invest, we could have had flat costs. But we want to get through this transformation program as quickly as we can.

Peter Francis King
Chief Financial Officer

And Jarrod, on the revenue side, if I think about it by division, we obviously had a lot of volatility in the Wealth business this year with claims, some of the pays, the reviews that we've had to do, so I think there's opportunities there in that business but also growth. So we're through the MySuper migrations now; they happened in the second half. Insurance business is looking good, so I think there's options there. In the banking business, mortgages are slowing, we can see that, but it's still growing, so there is still growth there. If I look at margins, as usual, there's lots of moving bits. I think everyone is very focused on the asset side. We've also got options on the deposit side, the funding side. The funding markets are looking the best they've been in some time. So there's always lots of moving parts on the margin side. And then New Zealand's got options. Yes, WIB, it was a story of 2 halves, but again, I think Lyn's got options within her business as well. So I wouldn't naturally draw the same conclusion that you have from those points.

Andrew Bowden
Head of Investor Relations

Victor?

Victor German
Macquarie Research

Victor German from Macquarie. I'm just hoping, Peter, to follow up on a couple of comments you've made earlier, just if you can maybe elaborate. The conduct-related charges, obviously big, big hit this half. I guess the reality kind of where we live today, that these things are probably going to continue into next half, to what extent do you think that number should normalize as we go into first half '18? And similarly, on volatility in your Markets income, so that seems to be a pretty volatile a number for everyone, but for you -- for Westpac in particular. Can you maybe give us a bit of a sense for why we're seeing this volatility and what do you think is kind of a more normal level in that business?

Peter Francis King
Chief Financial Officer

So I'll take the first one first. The risk income, yes, it was mostly in risk and the volatility which is you -- is what you expect. But if I look at the WIB business, 80% of the revenue is sort of customer related. And the challenge we have this half was -- is both the risk management in Treasury and Markets that were quite correlated for different reasons -- very different reasons, but I think it's similar to trends that we've seen. So it's always a bit difficult to forecast that business, but I've given you a long-term trend, so you can give it a -- yes, a pretty good estimate. Sorry, what -- your first question was?

Victor German
Macquarie Research

Conduct related.

Peter Francis King
Chief Financial Officer

Conduct. That -- I mean, where we're at is we're having a good look. As Brian said, it's -- the narrative of the company is have a good look, put it -- get it right, put it right. We've dealt with the things that we know at the moment, so there's nothing that we've got out there, but we are still looking. So we haven't completed, but I think we've got through the part -- the big part of it.

Andrew Bowden
Head of Investor Relations

Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Two quick questions, if I may. First one is, next year, the CLF actually goes up...

Peter Francis King
Chief Financial Officer

Yes.

Brian D. Johnson
CLSA Limited, Research Division

Which will pump up the LCR ratio by something like 10%. Does this suggest we're at the end of the lengthening of the wholesale funding running off the short-term funding? And then the second question is, on one of the slides, well, you actually said that the September month NIM was actually higher than it was for the second half. Now that's notwithstanding the fact I would've thought that the biggest mortgage repricing came through in the June quarter. Could you just run us through -- well, give us a feel on how much higher the exit rate was and the average over the period and, mechanically, why the September quarter was above the June quarter, given that's when the levy came through?

Peter Francis King
Chief Financial Officer

Well, I don't think I've disclosed the quarter-on-quarter piece, Brian, but let me just tell you about the trends that, you're right, the bank levy came in, in the last quarter, but we also had some mortgage pricing that have come through. And what that's left us with is we're a couple of basis points above the average for the half as we exited the year. So I don't think there's anything else more than that in terms of the margin story. Then on the CLF, the way to think about that is, you're right, it has gone up. Part of that, though, is I think we'll need to be around 130% on the LCR ratio, so part of that really goes to a higher ratio, but part of it can be used to fund growth. So that's the way to think about that increase in the CLF.

Andrew Bowden
Head of Investor Relations

Andrew?

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Andrew Lyons from Goldman. So I have just a question on your capital position. Pretty strong result at 10.6% for the half. Just 2 questions relating to that. I guess now we've got the line in the sand at 10.5%. How close sort of over time will you be willing to sort of run towards that 10.5% level? And then secondly, can you perhaps provide with just any update on the capital uncertainties that we -- that the business faces sort of towards the end of this year's -- I guess, if APRA's final announcement comes through?

Peter Francis King
Chief Financial Officer

Yes. So it'll be great to say we're final on capital rules but not quite there. I think we're close. We hope we will get an announcement from APRA if they run to the timetable they've announced this year. Don't think about 10.5% as a floor would be my first comment. If you think about how we've been running capital, we've had a preferred range that we run within, and that's set at a buffer above the 8% top of the capital conservation buffer. So I think we will reinstate that way of running capital once we have the rules, but that 8%, the capital conservation buffer, APRA needs to reset that number under the new rules, and then we'll reset our target ranges. So the way I think about is get to 10.5%, and then we'll wait for the detail that will help us understand which products need or have the extra capital that we're holding need to be allocated to them. So we're nearly there.

Andrew Bowden
Head of Investor Relations

Jon?

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Just following on to that. So once you're there, in the next year, you'll probably be pushing up to 11%. Hopefully, that's more than enough. Will your preference then be to look to return that excess capital, or would you use that excess capital to start reinvesting in productivity? And given the outlook changes going through, is it time to start accelerating that productivity initiative with the excess capital, or do you look to return it in that time?

Peter Francis King
Chief Financial Officer

Isn't it nice to be talking about what are we doing with the capital for a change? It makes a bit of a change for the last 5 years. I think we will always look at the best opportunity for deploying capital. So if we've got good productivity opportunities, we could go after those. If we're seeing better balance sheet growth, we'll support that. And if we don't, we can give back to shareholders. So the pleasing thing from my perspective is, yes, we've finished that -- the big build's done, if you like, so we'll have a look at all those opportunities.

Jonathan Mott
UBS Investment Bank, Research Division

And can you keep risk-weighted assets flat?

Peter Francis King
Chief Financial Officer

Well, I mean, turn it around, we're here to support growth in the economy. So if the economy is growing, I'm happy for risk weights to be going up. We'll obviously be focused on the best return from those assets, but I'd love to be saying that we're actually going to help the economy grow.

Andrew Bowden
Head of Investor Relations

Andrew?

Andrew Triggs

It's Andrew Triggs from JPMorgan. Just a couple of questions both sort of related to margin in a sense.

Peter Francis King
Chief Financial Officer

Sorry, Andrew, where are you? Oh, there.

Andrew Triggs

Here, sorry [indiscernible]. Just firstly, your expectations on interest-only customers that will switch ultimately to pay now, you said that it has slowed, but do you have any sense as to how many customers will switch? And secondly, again, on the margin side of things, term deposit pricing was obviously pretty intense at this time last year, and then Westpac did write a lot of your quite expensive 1-year TDs, how you'll see your sense on the likelihood of retaining those customers and how much of a sort of benefit will tailwind to margins in the first half as well?

Peter Francis King
Chief Financial Officer

So we are 3/4 of the way through that book rolling off, and we've retained the majority of that book, so we're pretty happy with the retention there. There's about -- I think it's about $5 billion left to go, so it's -- we're basic -- it's in the run rate, yes, broadly is the way to think about it in terms of those TDs. On the mortgage switching one, that's a hard one, but the way to think about that is, obviously, new flows are down to that 25% level. It's much harder for people to roll their interest -- existing interest-only for longer periods, so you'll have continued roll-off there. And then we've got the proactive switching. The proactive switching has been the piece that has slowed a little bit, but we're writing to customers again just to make sure they understand the differential pricing. I mean, my best guess would be around the same level of switching in the first half as we saw this. That would be -- you can't hold me to it, but that's my best guess.

Andrew Bowden
Head of Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. Just to follow up on the deposits side from the TD impacts that you just mentioned, is there any reason why the deposits weren't a boost to margins in the second half? I think that's Slide 15, now we're flat?

Peter Francis King
Chief Financial Officer

Yes, it was because the transaction account spreads still fail because of the tractor impact on the hedging. So basically, you had the benefit from the TDs, offset by the lower returns on the transaction accounts as the tractors come down.

Richard E. Wiles
Morgan Stanley, Research Division

Okay. So given you -- the comments that the tractor is unlikely to be a drag going forward, and you've still got more TDs -- expensive TDs to roll off, deposits should be a tailwind for margins in the first half, I think?

Peter Francis King
Chief Financial Officer

That's not unfair assumption.

Richard E. Wiles
Morgan Stanley, Research Division

And then, Brian, just a quick question on costs. Given your comments earlier, would it be fair to assume that the productivity's savings that you're targeting will be pretty consistent with the last few years, where it's been sort of $250 million, $260 million per annum?

Brian Charles Hartzer
MD, Group CEO & Director

That's a reasonable assumption. But I would say nothing -- I can't talk about a specific number. But I would come back to the fact that there is a lot of opportunity in the cost base, but it's structural that we've got to go to over time.

Andrew Bowden
Head of Investor Relations

We'll take a phone -- a call on the phone, please. Can I get Craig Williams?

Craig Anthony Williams
Citigroup Inc, Research Division

Gentlemen, what risk do you see with respect to higher mortgage risk weights? I suppose being a bit more specific to Andrew Lyons' earlier question about regulatory risk, do you think that the 10.5% CET1 level that you've had set at a sort of group level we will sort of encapsulate any movements in that already? And if risk weights on investor mortgages will sort of stay at 35%, do you have the means of dealing with this in terms of individual product profitability?

Peter Francis King
Chief Financial Officer

Yes, Craig, I think, well, that's been a risk that we've been talking about for a little while now that while we've got the headline ratio locked in, we don't have the product level and even subproduct level risk weights. And you're right, we expect mortgages to have subproduct level categories. But I think one things that you do when you get those is you actually change your strategy and you look at how you manage portfolio. So from my perspective, I'm pretty keen to get the details so that we can then look at the business strategies and respond to it because we've got a couple years before they come in. So...

Brian Charles Hartzer

MD, Group CEO & Director

There's another important point to make, though, Craig, and that is that when APRA announced the 10.5% target, remember, they also made it very clear that banks that currently met the 10.5% target based on the way things were done today would have enough capital on their assessment to meet that target even after those changes.

Craig Anthony Williams
Citigroup Inc, Research Division

So can we assume then that repricing changes that have been made in the industry for the added capital to meet the 10.5% should therefore be sort of dealing with any sort of price-specific capital adjustments?

Peter Francis King
Chief Financial Officer

No, I'm not sure we can go anywhere near pricing, Craig.

Andrew Bowden
Head of Investor Relations

Okay, I'll take another call from the phone. It's from Frank Podrug, please.

Frank Podrug
BofA Merrill Lynch, Research Division

A couple of questions from me. The first is congratulations on getting to 10.5% so quickly. How much more scope do you see the balance sheet optimization, whether that by EAD or RWA efficiencies? And where do you see such opportunities?

Peter Francis King
Chief Financial Officer

I think if you look at this year, I think the WIB team have done a fantastic job in the way that it managed the unused limits and growth. So I think there's a little bit more there, but that's been something that's been a big focus the last few years. And then I think the -- I think what we're going to have to have a look at is more the new rules and the subproduct levels. So that will, I think, throw up some opportunities for us. Yes, everyone is certainly working on opportunities, but I think that's the next piece for us to really get clear on that and how we change the strategy.

Frank Podrug
BofA Merrill Lynch, Research Division

Great. And second question is asset quality clearly remains outstanding. And in fact, it's getting better. Is there anything that you see so far that bothers you? And what I'm conscious of anchoring by, is there a case to be made that even after you account for changes in broad product and geographic mix, [indiscernible] or loss rates could be sustainably lower given a generally more cautious approach to lending within product classes in recent years?

Peter Francis King
Chief Financial Officer

I think, yes, it's an interesting question because if you look at where growth has been over the last 5 to 10 years, it's been in the housing market, the housing portfolios, and corporates haven't regeared. Yes, we still haven't seen corporates regearing, so that could say that, yes, compared to previous cycles that we've got different risk characteristics at this point because there's lower gearing, I wouldn't go so far as to say that in other parts of the business sector, though, because I think small business -- that's my beginner town that I'm referring to. I think small business is, by its nature, a little bit more riskier.

Frank Podrug
BofA Merrill Lynch, Research Division

Anything you've seen that's concerning you?

Peter Francis King
Chief Financial Officer

I beg your pardon?

Frank Podrug
BofA Merrill Lynch, Research Division

So on the first part, anything you're seeing at the moment that's bothering you on asset quality or a pretty good outlook?

Peter Francis King
Chief Financial Officer

No, I think, yes, the fact that the economic overlay came down, so the fact that we found it difficult to justify, so it's really the mining sector -- flow through the mining sector and regional towns is the area that's still working through, but a lot of that already were the risk estimates now.

Brian Charles Hartzer
MD, Group CEO & Director

But it's worth just adding to that there are regional differences as well. I mean, you mentioned the mining, but I think that the national economy has got a variety of areas we're performing in different levels, and so that's something we're certainly staying alert to.

Andrew Bowden
Head of Investor Relations

Can I just take a final question from Brett.

Brett Le Mesurier

Brett Le Mesurier from Velocity Trade. Two questions. Firstly, the investment property loans continue to increase as a proportion of your portfolio, and your flow is materially higher than the balances? And also, the use of brokers is increasing. Can you comment on those 2 trends? Is that part of your strategy to have higher investor loans in your mortgage -- in your Australian mortgage portfolio? And secondly, on the capital side, I've noticed the retained earnings in your life, general insurance and funds management businesses are a smaller deduction now. Can you comment on what's behind that?

Peter Francis King
Chief Financial Officer

So Brett, on the -- on investor, we are -- we've tightened up the criteria, so we're very happy to lend to investors. So I think it was in Brian's chart you saw it's slightly above the portfolio average in the second half, but that was, I think, 4.6% or something?

Brian Charles Hartzer
MD, Group CEO & Director

Yes, it's not.

Peter Francis King
Chief Financial Officer

It's not -- yes, it's in line with the system, so we're happy with that. On the mortgage broker piece, I think it was 43% to 46%. That's not out of WACC for what we see. It was at that level, I think, in the period last year, but it can go up and down depending on what's happening in the market. And on the life insurance capital piece, that was a good story. That was us working to consolidate a couple of life insurance industries and companies which released capital, and you can see that in the capital walk that's in the capital section.

Andrew Bowden
Head of Investor Relations
Okay. With that, thank you very much for your attendance, and good morning.