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 moving to the phones. To ensure everyone can hear you, please wait for the microphone, state your name and the organization you represent. And to allow everyone the opportunity to ask questions, please limit them to 2 questions. We'll now start with Jon Mott.

Jonathan Mott
UBS Investment Bank, Research Division

Just 2 quick questions if I could. The first one, you called out a lot of the headwinds for NIM, but you didn't call out a tailwind, which is kind of unusual. The BBSW is coming very sharply. I think it averaged 41 basis points through the last calendar year, and I think today, it's around 11. Previously, you called out that every 5 basis points of that move is 1 bp to NIM. So give or take, it's 5 to 6 bp tailwind that you should be seeing if this rate stayed at its current level. So I just wanted to double check, is that included in the comments that you've made?

And I'll -- kind of keep for my second question, if you look at the strong growth in the broker -- sorry, strong growth in mortgages, it's really been driven by broker. You're up to 48% of flow in this half going through the broker channel. And if you look at the numbers, it means that of the new sales, the proprietary sales in this half were down by 18%, but your broker sales were up by 15%. I just wanted to get a feel given the comments that you've made very publicly in the Royal Commission that -- about the broker channel. What's happened to turn the broker flow around so quickly and so substantially? And are you comfortable with almost half of your loans now being written via the broker channel given your comments at the Royal Commission?

Matthew Comyn
CEO, MD & Executive Director

Yes. Thanks very much, Jon. Let me deal with the first part. So I mean your math is broadly right. In FY '18, basis risk premium is 28 basis points. In FY '19, it was 48. So there's a 20 basis point headwind that we saw. You can see the same spread that we can on bills cash. So I mean we run a rolling 3-month average, which is why you have basically very little benefit at the back end of '19, but that's a tailwind, as you said, going into '20.

Okay. In the context of the broker market, I guess a couple of things. Clearly, if we can serve our customers directly, we would like to. The broker channel remains an important one. It's fair to say that my comments at the Royal Commission perhaps weren't positively received by everyone in the mortgage broking industry, but I think actually to their -- the industry's credit, what's actually enabled our growth in the broker channel in subsequent periods has been because we've had very consistent speed to decision and turnaround time. So we've been able to get back to customers same day within 2 days. We've seen examples in the industry of buying out sort of 20 days. And in the broker channel, they will preference service and reliability, which has enabled us to grow. So I mean in the context of the numbers you're using there including Bankwest, I think for the full year, we called out in our ASX release 41% versus system of 59%. So I mean the broker channel continues to grow. It's clearly a channel that many customers preference. We would love to be able to provide obviously a very compelling direct proposition, but we recognize that the broker channel is a really important one, has been for many years and will continue to be.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Jarrod.

Jarrod Martin

Crédit Suisse AG, Research Division

Jarrod Martin from Credit Suisse. Just looking at Slide 23 and the expense waterfall, trying to get an idea of what expenses are one-off or diminishing in terms of recurring and those that are actually recurring. So going through each of those items. So the 977 that also includes 450 extra FTE, of that 977, how much of is likely to be recurring? Then the -- you've got 600 additional FTE, particularly risk and compliance, what's your outlook for growth in terms of FTE numbers? The IT increases, you've increased investment by $100 million this year, outlook for that component. So I'm just trying to understand what's truly a one-off and what's likely to recur next year or increase next year.

Alan Docherty
Group Executive & CFO

Yes. We've provided some additional disclosure in both the ASX and the profit announcement around those notable items in particular. There's a large component of the current year cost on the notable items related to customer remediation provisions, including a full provision for expected ongoing service fee issues related to lined advisers. And so we have fully provided for all known issues. And as you know, Jarrod, we provide early and provide conservatively for those. The program cost component of the notable items, we've called that out separately within the 977. And that relates to, for example, our response to the APRA Prudential Inquiry through a Better Risk Outcomes Program and our work on uplifting our financial claim compliance through a program of action. So those programs worked on, they are time-bound but are multiyear pieces of work. So I think that bifurcation of the notable items between remediation costs and the program costs is important in that regard.

On the risk -- enhanced risk capability, we see the items generally on the right-hand side of that chart on Slide 23 has been items which are in the ongoing cost base of the enhanced risk capability, which I mentioned, about 2,800 risk and compliance staff across line 1 and line 2. They're doing a really valuable job in terms of working through the issues and making sure that we make the bank a better bank moving forward.

If you look at FTE on both a spot and an average basis, you'll see that the exit spot FTE was actually relatively close to the average FTE over the period. And I'd expect that number in terms of risk and compliance staff will be a recurring feature as we -- as the bank moves forward.

Other items within that right-hand side. Obviously, we're going to continue to focus on business simplification. That's multiyear work within the staff and IT costs. Some element of nonrecurring but generally that's -- take IT costs for example, there's an increased infrastructure volumes as a result of customers continuing to migrate from physical to digital distribution channels. So again, I think you'll see that as an ongoing feature of our results moving forward.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Victor.

Victor German
Macquarie Research

Victor German from Macquarie. Two questions, one on expenses and one on fees. On expenses, if I just can follow up on Jarrod's previous question that slide relating to -- 23. You're still targeting absolute cost reduction. Just so we are all clear on exactly what you're targeting, would it be fair to assume that you're targeting the number -- so your starting base excluding remediation charges, and it backdates to your original target announced last half. In other words, you will absorb that $200 million that you see increase in 2019. I remember last year, you talked about potential increases relating to bonuses and compensation. Just interested on how that played out this year.

And on fees, appreciate a lot of them -- a lot of good disclosure there, and we can see the movement from 2019 into what should be the run rate for 2020. But I'll be interested in your thoughts, maybe Matt, just broadly speaking. I mean CBA has taken a lot of initiatives. Do you feel like you're now leading the market on that? Or do you feel that there's more fee pressures to come? The market is still expecting to see increasing your fee line. Do you think that's a reasonable assumption over the next 2 years?

Matthew Comyn
CEO, MD & Executive Director

Yes. So why don't I answer both of those? Maybe Alan, if you want to talk specifically to the bonuses. So let me deal with expenses. So I mean our commentary and guidance, very consistent with what we've said at the first half. So broadly the way you described it is right. I mean absolute cost reduction, sort of working back from the slide that we provided there, we also sort of call out a sub-40% cost-to-income ratio. Obviously, in the falling income environment, as I know a number of you have noted, for every 1% reduction of income, we've got to reduce expenses by 2.5%.

I mean put another way, just building on some of the things that Alan said, if you look at that sort of enhanced risk capability, I'd say a good proportion of that, in my view, is structural. I think it's really important that we're able to -- I'd like to be able to automate a lot of that over time. I think it's really important we're able to deliver consistently good both customer and risk outcomes. Clearly, there's elevated numbers of people around customer remediation. We want to complete that work as quickly as possible and return that money to our customers. And then if you look at the other areas where we're up to sort of $259 million, we talked about some of them in the context of we've added additional people into our, what we call, financial assistance solution, which is also the teams that deal with customers in arrears. It's one of -- probably the primary reason that we've been able to improve our 90-day home loan arrears rate, for example. We've added extra home lending business bankers. We've added extra staff to deal with complaints particularly dealing with the introduction of the new Australian Financial Complaints Authority.

So we sort of feel like in many of those areas, we've got a good return on that investment, an extremely good, in some cases, return. But then when you get to that $190 million, given that softening revenue environment, we just feel like there's genuine cost-out there from simplification and much better cost discipline. There's just more work to do there, and we've got to be able to demonstrate that next year.

Then maybe your question on fees. So in the majority, I guess I would say my -- our outlook overall on ABI in particular especially stabilizing from that point, so that -- majority of that shift from $275 million to $415 million, a lot of that is the full year effect of fee changes that we've made particularly in our wealth business, so in our CFS business that I think there was only 1 month of the $70-odd million, for example, within that. So as you said, we tried to call all of that out in the third quarter. We feel like we've made absolutely the right steps and some deliberate choices. We also believe very strongly in transparency, so providing some of that alerting capability. But I think overall, we're in a good position. And obviously, with volume growth in some areas, we'd like to see an uptick in fee income as well.

Alan Docherty
Group Executive & CFO

And on bonuses, you'll recall this time last year, we had significant reductions in equity-based compensation, deferred equity for a number of senior executives. So we've seen that come back to more normal levels in the current year. So that's been an element of headwind within our operating expense base, and you can see that detail in the operating expense note and in the profit announcement.

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 Sachs. Just a question on your NIM. The disclosure around the impact of the cash rate cut today has been very helpful. But the market is now pricing close to further 2 cash rate cuts by early next year. I assume you're not going to give us any guidance around what that might mean for the NIM. But is it fair to assume that just given where various deposit products are now pricing, that the impact of a further 2 cash rate cuts will be more than the first 2? Then just a second question. Just you note the 9% increase in your investment spend, a big increase. All of the increase in that came from compliance at the expense of productivity growth and other. I'm just wondering with a $1.4 billion investment spend budget for the year, are you comfortable that you can maintain adequate non-risk and compliance spend within that?

Matthew Comyn
CEO, MD & Executive Director

Why don't I -- and Alan, please add. So as you said, we called out the 4 basis points. I guess it's a combination of the impact of the rates as well as just the shift in the yield curve, and therefore the tractor or the earn rate on both the replicating portfolio and the duration of equity. We've -- similarly, we've priced in one more cash rate. No, we're not going to give the specific impact, but your overall assumption that each subsequent rate reduction costs more is right, and we called that out when we did the latest pricing change that there's $160 billion of deposits where we currently either can't pass on at all or in full. And as you'd expect, that pool of deposits both grows and the impact of that limited pass-through increases.

In the context of your -- the question on investment spend. Yes, I mean we're very comfortable with that level of investment spend. It was a modest increase. We've got about 5,500 people working on projects. We feel like we're constrained more into the context of capability and capacity and our ability to deliver and execute and get a good return on that investment. We feel that there's enough envelope clearly within that to invest in the necessary regulatory and compliance. But if at any point over the long term, we thought it was necessary to invest more to strengthen our overall franchise, then we'd be prepared to do that subject of course to having availability of the right level of resources.

Melanie Kirk
Head of Investor Relations

We'll take the next question from James Ellis.

James Ellis
BofA Merrill Lynch, Research Division

It's James Ellis from Bank of America Merrill Lynch. A question on costs and a question on the business institutional balances. So we've seen continued contraction in business and institutional. Just wondering to what extent you expect that to continue into future periods or whether we're done there? And then secondly, on your strategic cost program, you've obviously not put a target in terms of the -- those -- when you expect to achieve those strategic outcomes, but on one hand, it's 6 months. So you've got whatever point in time that is a bit closer, but then you're calling out a tougher revenue environment, so certainly the cost-to-income ratio component of the target is maybe a little bit further away. So does it feel like it's getting closer or further away at that point in time? So the business, the institutional balance contraction, and is it getting further off or closer?

Matthew Comyn
CEO, MD & Executive Director

Yes. Look, I mean costs, we've said I think a number of times, we're basically targeting that over the medium term. I appreciate that's not a particularly helpful descriptor. I don't have anything more beyond that other than to say clearly, it's something that's at the forefront of our mind, but we're going to be prepared to make the right choices rather than slavishly hold ourselves to that target in any sort of 6-month period.

On the institutional bank performance, as I called out, we're very comfortable with the disciplined focus on both price and risk. That $2 billion of organic capital in the last 12 months has been extremely effective. Some of that gets harder in the context of go-forward. So I wouldn't necessarily base that level of rate of serve reduction and balances certainly going forward. We want to support the institutional bank. It's a really important part of our overall business in serving our customers. We're also conscious that we want to make sure that we're able to earn the right level of both risk and return in that business.

Melanie Kirk
Head of Investor Relations

We'll take the next question from Andrew Triggs.

Andrew Triggs
JP Morgan Chase & Co, Research Division

It's Andrew Triggs from JPMorgan. Two questions, please. First one on the consumer finance portfolio. Looking at the average balance sheet, the yield on that book continues to fall by about 20 basis points this half, 27 basis points last half. Just an idea or a sense of if that magnitude is likely to continue and what the sort of dynamics are at work there. And the second question, the interest-only -- the percentage of flows in interest-only down to 22% and now in line with the percentage of the portfolio to 22%. Does this imply that the drag from switching is likely to be very little going forward? Or could we see a scenario where the percentage of the book dips below the percentage of flows?

Matthew Comyn
CEO, MD & Executive Director

Why don't I take consumer finance? I mean there's a couple of things that are happening within that book. First of all, there's much lower growth both on the credit side as well as personal lines. I mean our balances, they are shrinking, we're gaining share. I mean the other thing that's changing there in the context of what's impacting net interest margin is the revolve rate or the proportion of balances that are attracting interest. So that's continuing to come down. Sorry, your second question was -- oh, stock portfolio in terms of the headwind. Yes, that's the right assumption. I mean when we think about switching, I guess there's a couple of different elements to that. One is switching from interest-only to principal-only interest, another is investor to owner-occupier, another is variable to fixed. The majority of that headwind that we've been experiencing has been around interest-only switching to P&I, and exactly as you said, when stock equals flow, you assume that, that drag in future periods is going to reduce and stabilize.

Alan Docherty
Group Executive & CFO

That sequential margin drop in consumer finance shows the other factor at play there is, of course, the treasury reforms, the credit card interest. They were effective from 1 January this year. So you see that's the major driver of the sequential move in yields.

Matthew Comyn
CEO, MD & Executive Director

Yes. I think in the third quarter, we called out a $52 million full year impact, so work out is basically half of that in this result.

Melanie Kirk
Head of Investor Relations

Great. We'll take the next question from Richard Wiles.

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. A couple of questions, one on dividend and the other on capital and investment. I'll start with the latter. So it looks like you've got $6 billion-plus of surplus capital, above the 10.5% minimum once you get that life company deal done. What's the potential -- or are you considering taking some of that $6 billion and investing it back into the business, accelerating the investment in order to respond to the changes in the environment?

Second question relates to the dividend. In 2015, your ROE was 18%. Your payout ratio was 75%. Today, the ROE is less than 13%, so it's fallen by 5 percentage points. The dividend payout ratio, if you exclude the notable items, is 80%. So I just like to know how you're thinking about sustainability of the dividend.

Is it appropriate to have a higher payout ratio when your ROE is so much lower? And do you expect the payout ratio to get back to 75%? Or do you think it just stays above 80% in the future and that's okay?

Matthew Comyn
CEO, MD & Executive Director

Look, I'm happy to make a start, and then, Alan, why don't you add to that? Look, I mean there's multiple elements obviously embedded within that question, Richard. I mean one of the ways that we think about -- why don't we just talk about the dividend to start with? No change to the payout ratio. I think that serves the organization well for some time. Clearly, we're outside the payout ratio, at the upper-end including notables and above it -- sorry, excluding notables and above it including notables.

We still feel that, that payout ratio is appropriate. It's a lower-growth environment. So what are some of the things that we're thinking about or the Board, which is making that decision on dividend at any point in time, is considering both at this stage obviously the overall capital position as well as growth, return on equity is an important driver in terms of what that payout can be. We're in a lower credit growth environment, so we're going to have lower RWA growth. So I think being -- just working it through the upper end of that payout range is not a particular problem.

In the context of our capital position, as you said, where we stand today, including both the asset management business sale as well as other capital that should be received, subject to various regulatory approvals, in those divestments completing, then again, that's a Board decision. It's something that we talk about on a monthly basis in the context of how we're thinking about our overall capital plan and strategy. There's not much more that we can say at this point other than clearly, as we're getting into a position of surplus capital, we will continue to invest in our business. But a reasonable expectation that a proportion -- a good proportion of that surplus capital will be returned to shareholders at the appropriate time, subject to operating conditions and subject to the Board's decision.

Alan Docherty
Group Executive & CFO

And the other context, Richard, around historic dividend payout ratio and the middle of that range of 75%. But that's obviously been in the context of a period of capital build over many years. And so the very strong muscle of developed capital discipline and organic capital generation just I think provides the Board with additional flexibility as it -- as we work through the various considerations as we manage capital into the future.

Melanie Kirk
Head of Investor Relations

We're going to take the next question from the phones, and we've got Brendan from Citi on the phone.

Brendan Sproules
Citigroup Inc, Research Division

It's Brendan from Citigroup just coming through. I've got 2 questions. Firstly, on the home lending market. Obviously, you've been able to restore your growth relative to system in the last 6 months. And Matt, you've mentioned the ability to execute better in the broker channel. I was wondering if you can talk about front book pricing in that market. Particularly now that we've had 2 RBA rate cuts, to what extent are prices still well south of where your average back book is. And my second question relating to institutional business. You've obviously had quite a bit of lending book contraction over the past couple of years. I was wondering what the outlook for the cost base in that business and whether there will be a consummate reduction in the operating costs looking forward?

Matthew Comyn
CEO, MD & Executive Director

Sure. So why don't I start on home lending and then I'll let Alan talk to the cost base around institutional? I mean overall, the level of discounting, at least as we see it, is relatively flat over the course of the 12 months in terms of particularly the discounting away from the standard variable rate. What we've seen increasingly come into the market is a number of institutions competing heavily, particularly around cashback offers. What started out as a cashback around refinancing then became a cashback on any new loan and then it became a cashback on multiple securities. And so the cost of how that sort of get manifest itself generally is it will be capitalized and then amortized over the life of the loans. So doing $2,000 cashback, 10,000 loans a month, you're building up a cost base there of $20 million a month. So we're watching that dynamic very carefully. As you'd appreciate, there is intense competition. We see that flow through in terms of for every customer that we're serving on a day-to-day basis, there's also increasing recognition and transparency about what sort of pricing would be available. So you see existing customers, even their refinance, is probably on a relatively low rate on a historical basis. That's not to say there aren't customers that are actively approaching and wanting to negotiate in the home loan. So we see those various dynamics sort of show up in how we think about asset pricing overall, and some of the loans that are being repaid are at higher margins than those that we're originating today. So that's also been a drag in the period on home loan pricing overall.

Alan Docherty
Group Executive & CFO

And on institutional banking, I mean obviously Andrew and the team are looking very hard and have been over the past 18 months, 2 years around rightsizing the cost base as we see the lower revenue environment. You'll have seen in the period the costs were down 2.2% in the institutional bank year-on-year. In the prior year, we had a software impairment. And so there was, on an underlying basis, a good momentum built from the tail end of last year in the institutional cost base. And if we look at cost-to-income ratio, it's still at the low end of the range for an institutional bank. So we've got a cost-to-income ratio in the 42%, 43%. And so as we rightsize the portfolio mix and the mix of capital-intense lending revenues within the institutional bank, Andrew and the team are very focused on rightsizing the cost base that's commensurate with the top line.

Melanie Kirk
Head of Investor Relations

Great. We'll take the next question from Brett.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

Brett Le Mesurier from Shaw and Partners. Was it your intention to indicate that the net interest margin would be 2.05%, the most likely outcome for this financial year?

Matthew Comyn
CEO, MD & Executive Director

No. As you know, Brett, we don't provide guidance on net interest margin.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

Given what you said about the headwinds and starting at 210, that's the logical conclusion. Was that what you intended to imply?

Alan Docherty
Group Executive & CFO

No. I mean what we've sought to do is provide some transparency around known events. So one known event is we've got a new lease accounting standard. And under that new lease accounting standard, we have to bring in new interest expense into account so clarifying the outlook on that basis, and we've also had 2 known events in terms of 2 recent cash rate cuts. And so given some transparency around not just the impact of those rate cuts themselves but also the lower yield curves and the impact that has on replicate and equity tractors because they are difficult to model. And so we thought we'd be -- provide some additional clarity around that aspect. They are both known events. There are a lot of other variables, as you know, within net interest margin. We're not seeking to try and second-guess the number of other variables.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

Just moving on to the disclosure you gave on transaction balances on Slide 14. You said they're up 9%. When I look in the average balance sheet, I find no growth in transaction balances from the first half to the second half.

Alan Docherty
Group Executive & CFO

Are you including noninterest-bearing deposits in that?

Brett Le Mesurier
Shaw and Partners Limited, Research Division

They didn't move either. Noninterest-bearing liabilities is the disclosure you give. They didn't move either. So can you reconcile the large increase that you show in the slide pack against what we see in the average balance sheet?

Matthew Comyn
CEO, MD & Executive Director

Well, I can reconcile it insofar as the vast majority of the growth will be in the first half versus sequentially. So you do the balances in terms of a full year, year-on-year, so I'd have to look at it. But I'm sure the calculation works, but I don't have the sequential breakdown in terms of balance growth.

Brett Le Mesurier
Shaw and Partners Limited, Research Division

The transaction balance is in that slide pack. They include the mortgage offset accounts, I presume. Is that correct?

Matthew Comyn
CEO, MD & Executive Director

They would. Yes.

Alan Docherty
Group Executive & CFO

Both transaction deposits on an average balance basis are up on both full year and you can see average of the 3 halves.

Melanie Kirk
Head of Investor Relations

Great. Well take the last question from Azib Khan on the phone. So we'll turn to the phones again.

Azib Khan
Morgans Financial Limited, Research Division

Matt, you mentioned early in your presentation that in terms of the Remedial Action Plan, you've completed 75 milestones out of the 156. Is your expectation that once you've completed all 156, the $1 billion operational risk capital add-on will be removed?

And my second question is about potential NIM tailwinds. You've already covered the basis risk part. But in terms of your deposit mix, that's obviously changing favorably at the moment. You're experiencing strong growth in your transaction deposits and contraction in your term deposit book. Presumably, at least some of that dynamic is due to the lower rates being offered on TDs. So if we see further cash rate reductions, is your expectation that there will be a further favorable change in that customer deposit mix?

And also on NIM tailwinds, can we expect the portfolio optimization initiatives that you're undertaking in IB&M to be margin positive? And one of the reasons I'm asking this last part of the question is because you have been conducting some optimal in the institutional loan book for the last 12 or 18 months, but we've seen the NIM contract. Can you explain why that NIM in IB&M has been contracting?

Matthew Comyn
CEO, MD & Executive Director

Yes. So Alan, why don't you take the IB&M NIM? Let me deal with the first 2 parts of your questions. So look, the milestones in the context of completing the overall program. Basically, one of the conditions of the Enforceable Undertaking, as you said, was that op risk capital. It's incumbent on us to be able to demonstrate to APRA and to make an application for either a partial, or at the appropriate time perhaps, a full reduction. One would think it's very closely linked to the delivery of the program, but of course, it's up to us to be able to demonstrate that.

Secondly, I mean on the NIM tailwind or just around deposits, obviously, a number of different dynamics there. So first of all, falling interest rate environment, as I said, that $160 billion of deposits gets larger, there's a bigger impact from subsequent cash rate reductions, I'd say. I mean the term deposit pricing at the moment is very low-margin business, in some cases. As the yield curves fell quite rapidly, there's a period there of probably negative margin before rates really are adjusted. So I mean there's just -- there's a lot of different dynamics to try and sort of translate even then for us how that sort of plays out. Of course, an element of that is going to be competitive intensity for deposits as well. We certainly will be very focused on our Transaction Banking franchise. We think the ability to be able to perform well there gives us a very strong sort of liability-led funding advantage.

Alan Docherty
Group Executive & CFO

And on institutional banking, the portfolio optimization within institutional bank translates in improved portfolio mix, so improved lending margins at group level. If we then look at divisional, Institutional Banking & Markets margin, that's up 2 basis points over the year although there's an offsetting dilutive effect of the lower-yield environment. That lower-yield environment translates into lower net interest income at our markets business. And so that has a dilutive effect on net interest margin relative to the dynamics we're seeing on lending mix.

Melanie Kirk
Head of Investor Relations
That brings the briefing to a conclusion. Thank you for joining us. And if you have any follow-up questions, please reach out to the Investor Relations team. Thank you.