Question and Answer

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Andrew Lyons from Goldman Sachs. Just 2 questions relating to the growth in your IB&M balance sheet. Just, firstly, to the extent that you noted the chunk of the growth relates to capital markets, I guess, coming back to bank balance sheets. Given the volatility we're seeing in BBB spreads and I guess, the increase in BBB spreads, would you expect going forward any alleviation of margin pressure in that space? And just secondly, can you just comment if any of the growth that you've seen in IB&M balances relates to the drawdown of companies, particularly resource companies who could be under some stress?

Ian Mark Narev
Former Executive

On the 2 points, Andrew. Number one, on the margin, look, there are aspects of the margin in Institutional Banking, which are probably a bit more cyclical, but there are clearly structural aspects as well. And as we think about the world that we're in, monetary conditions around the world, David mentioned Japan as an example, there is liquidity there, and there are well-resourced providers of liquidity looking to back good credits. And as David mentioned, what you will see particularly with banks and many of the other players in the industry is that we're reasonably risk averse in a sense, and therefore, we're all chasing better risk assets. That does create an industry with different structural elements, for example, the consumer banking that we do, and we wouldn't expect really significant alleviation of the competitive conditions. What we can say is that we make sure that our pricing is a good long-term return on the risk and above the cost of capital. And that's going to continue to be -- it's going to be the focus of the business. In terms of your second question, that has not been a significant driver at all of exposures during this period. And we track this very carefully with committed exposures drawn down, uncommitted exposures drawn down. As you can imagine in these sorts of environments, the earliest leading indicator of stress in any part of the sector is if uncommitted exposures are drawn down heavily. We watch that very carefully. We're not seeing any material difference in terms of the companies we're backing that would underpin this result or in fact at all.

Melanie Kirk

We'll take the next question from Craig Williams. Here.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. Look, you've characterized this result as a volume story, I think, today and referenced that a couple of times and indeed, with risk-weighted asset growth of 11% and I think interest earning asset growth of about 9%, it was indeed. If we look at the capital waterfall on Slide 51, I think you've earned 122 basis points of capital in the half. Supporting your balance sheet, you've required about 66 basis points if I add the 28 and the 38 together, which leaves your residual capital position of 56 if my math's right, and your dividend payment for the half is 77. So there's a net shortfall there where CET1 is falling. So how do you reduce the capital intensity of your business moving forward in an effort to maintain and protect the dividend?

David Paul Craig

I think that there are some timing differences there. Obviously, we're looking at a final dividend, and the interim dividend we're about to pay, of course, is lower than that. The volume growth that we've had, which was particularly in the institutional bank, we see as more of a one-off, as I've explained already. And regulatory treatments, this was sort of perhaps an abnormally high period. Interest rate risk in the banking book, again, a number of swing factors there, as I've mentioned to you. In a sense, you're counting some of the capital raise there as well. So looking forward in our capital plan, we see good organic capital growth.

Melanie Kirk

We'll take the next question from Jon.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. A question on funding markets. Obviously, in the last 6 to 8 weeks since the Fed raised rates, we're seeing capital -- the funding markets deteriorate very sharply, and that's continued over the last week or so. If the funding markets continue in this vein or even stay at these levels over the next sort of 3 to 6 months, will the repricing that you've already put through for your mortgage book be sufficient to offset these funding pressures to stabilize your margin at that level? And also, a follow-up question, if I could, on the capital. One of the things I picked up just going through the higher risk weights was the corporate risk-weighted assets were up by 15% in the half, so quite a material increase in corporate risk-weighted assets. And that was possibly one of the reasons why risk-weighted assets rose so aggressively in the period. Can you just also address why that part was up?

David Paul Craig

Well -- sorry, just on -- let's just take the second part first, which is corporate risk-weighted assets, which is entirely this institutional bank thing. So the mixture of the infrastructure funding that we won together with the debt capital markets refinancing of our customers, the growth is all there. As we would say, this is a sort of a bit of an aberration of timing, we think, rather than an ongoing substantial growth in that area, but that's what it's about. It's not about -- I think it's important to understand it's not credit quality; it's volume. And we're always here to support our customers. On the question of funding markets, I might ask Paolo Tonucci, our treasurer, to comment in a minute, but from our point of view, well, you know that we won't comment specifically about pricing on any particular area. We're not allowed to do that. But obviously, in terms of funding costs, we're not seeing -- while we're seeing trends impact that us, we remain pre-funded. We have done, as Ian said, a substantial portion of our funding already this year, so we're sitting in a comfortable position. And obviously, we'll seek to borrow at times that are sensible, and then we'll obviously seek to see how that pans through in terms of overall cost. But Paolo can give you more color.

Paolo Roberto Tonucci
Former Group Treasurer

Yes, thanks, Jon. I'll just want to answer that. I think the impact of wholesale funding costs has been quite modest. If it continues, we'd certainly expect to see an increase in the average cost of our funding. But it's quite modest, the amount of refinancing that we have in any one year being quite a small proportion of the total outstanding. In terms of the basis spread, which I think has seen some media attention, that comes through a little bit quicker. But again, it actually only affects a relatively small amount of our overall funding, so the impact of that is also quite small.

Ian Mark Narev
Former Executive

I think the other thing in terms of -- it's very important to understand in terms of how we think about funding costs. In these sorts of markets, there's always a tendency to say this has happened for the last 4 weeks. What if it happens for the next 6 months? And then 2 months later, something else has happened for the last 4 weeks. And one of our core responsibilities as a financial institution is to intermediate markets on behalf of our customers. So we are looking daily at movements in long-term wholesale funding costs, money markets, basis risk spread, deposit competition all the time. But we're also as a big financial institution with a big balance sheet got to be very careful about not making reactionary decisions that are going to cause concern to the customers. And I think that's something in volatile markets like this, and we all remember 2008 and 2009, we're all doing similar jobs at that stage. We just got to be very careful about making sure that we're taking a good long-term view of this while being cognizant of any short-term movements.

Melanie Kirk

Jon, can you pass to Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Just in reference to expenses, Slides 34 and 35. Ian, you made a comment that you're increasing investment spend. Can I challenge that a bit? Because if I look at the breakdown of the investment spend on Slide 34 and then apply those percentages, in fact, your investment in productivity and growth would be $357 million in first half '15 and $354 million in first half '16. So in fact, not an increase in productivity and growth. The whole increases effectively come through on that risk and compliance, that if the math is correct, going from $166 million to $245 million, an increase of nearly 50% in 12 months, which isn't revenue-generating. It might be revenue-saving but it's not revenue-generating. So to the extent that are we going to see risk and compliance costs even go up even further from here and therefore you actually have to increase your overall investment expenditure even more? And that puts pressure on headline expense growth that was 6% on pcp or 3% half-on-half? Can you make a couple of comments on it?

Ian Mark Narev
Former Executive

Yes. As I mentioned, your math is obviously right here, working out that combination of the mix of investment spend of the right-hand side of Page 34 with the absolute levels. And if you look at the different parts of that, we don't consider, as a financial institution, we are yet at the end of the requirement to invest heavily in risk and compliance spend for all sorts of different reasons. Now at some point, whether it's me or someone else, a chief executive will be here saying that amount is coming down, over the next 6 to 12 months, it won't. It may well -- the growth may be coming down a little bit, but that's a factor of being a financial institution in the post global financial crisis arena, and it's a pressure affecting the whole sector. What we've said is what we won't do because of those pressures is cut the investment and what's required to make this competitive for the future. Now I don't think that this institution needs to be spending radically more than $350 million in the half to prepare itself for the future. In fact, the discussions that we have with the management team and with the board are that the constraint is actually changing the organization versus dollars. But where we have got good headline income growth as we've got, we'll be prepared to continue to spend to make sure that we're keeping pace with it. Because one thing that people do forget sometimes is, yes, markets are volatile. Yes, risk and compliance costs are going up, but the rate of innovation isn't slowing. The rate of competitor -- new competitors isn't slowing. And one of the big risks of the financial sector at the moment is that they try and impress the market with short-term cost results. They can't cut risk and compliance costs, so the only way you do it is cut future investment costs. And if we do that, we'll be in a very uncompetitive position in 2 or 3 years.

Melanie Kirk

We'll take our next question from Andrew Hill.

Andrew Hill
BofA Merrill Lynch, Research Division

Andrew Hill from Merrill Lynch. Just a couple of questions on credit quality, if that's okay. I'm looking at the table on Page 81 of the financial statements, which just shows the credit ratings of the commercial portfolio. From those numbers, it does look like there's been a decent deterioration in the ratings of the portfolio. I'm just wondering how that reconciles with the ongoing declines in collective provision coverage. And then a related question of -- I appreciate the reluctance to react to short-term market movements. If we're sitting here in 6 months' time and the paranoia about market conditions has continued, will you then be in a position to raise your collective provision coverage by the management overlay? Or is it an open-ended issue?

Ian Mark Narev
Former Executive

Well, I'll let David speak about the overlay thing in a minute. In terms of the commercial portfolio quality, the better way of looking at this is looking through the capital charts and the Pillar 3 charts about the impact of deteriorating assets on the book. This is a combination of obviously the portfolio and origination. And yes, you can see very small changes in 81, but what you can see through the cap of the impact of credit quality on the capital and also through the Pillar 3 disclosure is there's really no endemic credit quality issue to speak of at all. So yes, the combination of where originating credit [ph] can have small impact on these sorts of charts, but we're not seeing any signs of that kind of endemic credit deterioration. And I keep emphasizing that doesn't mean we or anybody should be complacent, but it does mean that, that these forces that often people are talking about are not showing up as we sit today in the results of the business.

David Paul Craig

Yes, just to add a little bit more color to what Ian is saying. What that chart shows you, the first 3 lines are investment grade and then the bottom line is sub-investment grade. And the sub-investment grade is exactly the same as it was 12 months ago at 30.2%. So we have exactly the same investment grade exposure as we did before, just some slight mixes within it. So that has a very negligible impact on collective provisioning. What was your question about the

overlay?

Ian Mark Narev
Former Executive

Collective provision. If conditions continue for 6 months, would we increase the overlay in the collective?

David Paul Craig

Well, the overlay -- the key to understand is that the models automatically adjust the collective provision. So every time there's any account regraded up or down, that automatically flows through the model, including, I might add, in the overlay because within the overlay is a 20% overlay on top of whatever happens below. And that 20% overlay is for that [ph] model and data correction, so you'd also move. So yes, the answer is they do move with credit quality and what you can see in aggregate is they have not moved very much at all in the last 6 months. And as I said, to the extent it has moved, it's largely been volume rather than quality.

Melanie Kirk

We'll take the next question from Brett.

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

It's Brett Le Mesurier from APP. Could you tell us what the ROE in your Institutional Banking & Markets business is? The return on assets is 0.7%. So if we just apply the average leverage in your business, the capital relative to your assets to that business, you simply get a number of 10% which, of course, you'd like to think the ROE is greater than that. But it's also been following the return of assets from 0.8% to 0.7%. So I'm interested in the return on equity in that business and what the incremental return on equity was in that business because you referred to putting on new business, which was better than your cost of capital but it also looks like you must think your cost of capital is pretty low.

Ian Mark Narev
Former Executive

I think obviously we don't disclose returns on equity by individual businesses. But what I can tell you is that as every iteration of the IB&M strategy comes before the executive team and the board, we look at it very carefully to make sure its returns are above the cost of capital, and they are above the cost of capital. So if the business continued -- number one, as both David and I have said, a 17% growth in balances in this period is abnormal for good reasons because we've been involved in value-creating transactions. But if it continued to grow at levels of the return we've got at the moment, we'd be quite happy to do that from a returns perspective. It's good for the shareholder.

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

Do you think your [indiscernible] cost of capital compares to the average ROE that the company achieves?

Ian Mark Narev
Former Executive

Again, from the point of view of the cost of capital and the returns, every business is positioned from its strategy to make sure that it is a positive contribution to profit after capital charge or whichever measure you want on ROE. So business by business, all the businesses are returning above the cost of capital in the businesses that they're doing.

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

So I presume then the company average ROE exceeds your cost of capital as you view it.

Ian Mark Narev
Former Executive

The company average ROE exceeds the cost of capital, yes.

Melanie Kirk

We'll take the next question from Victor.

Victor German
Macquarie Research

Victor German from Macquarie. Just maybe following in sort of the theme from previous questions. If I could touch on credit quality, obviously, the market is somewhat concerned about mining exposures. And I understand it's only 1.8% of the book, but it's still a reasonable number. And given your balance date is December, and we've seen some further deterioration in that space, it would be interesting to hear sort of maybe some color as to how you do your stress testing and sort of what levels have you actually stressed to and whether we should expect potential issues in that space.

Ian Mark Narev
Former Executive

Well, the first -- a couple of points on it. Number one is I think on the mining, oil and gas, I think about 79% of the exposures in that category of the oil and gas are investment grade. And the strategy for quite some period of time, and this goes back now a number of years, has been very much focused on where different providers sit on the cost curve. Now as you can imagine in these sorts of environment, at senior executive risk committee levels the business we go through name-by-name. We have a look at the exposure we've got and how they're doing. As we go through name by name and position these individual names on the cost curve, they're in pretty good positions on the cost curve. Two things that I'd say as a caveat to that. Number one, it doesn't mean that we or any financial institution is impervious to losses. And number two, critically, given the structure of these markets, the structure of the offtake arrangements, the structure of take-or-pay arrangements, hedging and all those sorts of things, to the extent that there's stress in these areas, you are not going to see it necessarily turn up in the first month if you've done good lending. You've just got to be careful about how this looks month-on-month and, in fact, year-on-year. And that leads to my answer to the second part of your question is, without disclosing any specific parts of the variables on the stress test, what we're doing is stressing different levels of commodity prices over 2, 3, 4, 5 years and looking at those sorts of stresses because we'd be fooling ourselves if we said because we've had no significant deterioration now if it continues to the next 2 or 3 years, we won't have a problem. But we're watching it very carefully. And we keep coming back to the fact that the companies that we targeted, the counterparties we've targeted, have generally been the right places to be in the sector.

Victor German
Macquarie Research

So would it be fair to say that the recent deterioration in commodity prices, particularly in oil and iron ore, would be within the stress parameters that you already tested going into this realm?

Ian Mark Narev
Former Executive

Yes.

David Paul Craig

Well we've also stress tested at lower levels than the current levels. So clearly, we've seen the current levels and stress tested those. Indeed, we've done that for quite some time. But we've actually also stress tested at lower levels.

Victor German
Macquarie Research

But I'm assuming that hasn't flowed through to your provisions yet, those stress scenarios?

Ian Mark Narev
Former Executive

No.

Victor German
Macquarie Research

And second question, and apologies if it's sort of a basic mathematical question. But just looking at your net interest margin decline in corporate space of 7 basis points, I'm assuming that in corporate, it's both the business and institutional, and institutional is only about half of that in terms of interest-earning assets. So it sort of implies if I take your comments, David, as sort of business was broadly flat, it suggested institutional decline was actually quite material. And it's not quite obvious when I look at divisional disclosure because yes, balances were up 12.5% but interest income was also up 9%. What am I missing? Is there sort of anything else that's sort of playing in that margin that's not obvious?

David Paul Craig

There's also fees. But don't forget the thing that you're perhaps missing and I should have mentioned, I think, when I presented on this, is deposit margin. So the fact that we're in whatever number of years now very low interest rates means that the impact of our sort of funding costs -- sorry, our average costs are all flowing through. And so we're making much less progressively on deposits than we've done historically. So deposit margins as it were would also be playing through in that result. But yes...

Victor German
Macquarie Research

And that's including replicating portfolio issues as well?

David Paul Craig

Exactly, yes, exactly. So the replicating portfolio is still providing a benefit, but the benefit it provides diminishes each period. So that flows through to margins across the whole business. But in particular it's part of the story on the declining margin.

Victor German
Macquarie Research

Are you able to break it up at all for us in terms of contribution from the deposited issue relative to lending spreads?

David Paul Craig

No, we don't do that. But there is a diagram on the replicating portfolio in the back of the pack that gives you a sense of that.

Melanie Kirk

We'll take the next question from Andrew Triggs.

Andrew Triggs
Deutsche Bank AG, Research Division

It's Andrew Triggs from Deutsche Bank. Just a couple of questions please, firstly on the investment being made in IB&M. Which sides or which parts of the business does that relate to? Is it more along the lending markets or transaction banking side of things? And what gives you the confidence there to invest? Is it a cyclical view investing at the bottom? We know that returns are lower relative to other divisions. And then the second question, just a bit more on the funding cost side of things. The NSFR, an area where APRA has called out the major banks might need to do or don't usually meet 100% requirement. What do you think the outlook there is and the timing impact of perhaps the banks -- major banks, a, going back harder into deposit markets, and b, lengthening duration of wholesale funding?

Ian Mark Narev
Former Executive

Let me take the IB&M question first and then David can talk about the NSFR. If you go back, I think, to the strategy slide that we put up in March or April 2012, one of the things we specifically called out was growth in business and institutional banking. In this period, I think we put 150 people on in the business bank. We put a couple of hundred people on in Institutional Banking & Markets. To your question about strategy, there are couple of parts to it. Number one, particularly, institutional banking and to some extent in business banking, these have been subscale businesses for us relative to our competitors. And a big part of this has just been making sure that in terms of capability, and that's not just people numbers but making sure that people quality is there as well, we've got an institutional bank, which from purposes of both origination across all the different asset classes and risk management and technology is a competitive investment bank -- an institutional bank and that's what we've done here. So it's sort of right across different parts of the business and you can see for a while, we've talked about participating better in some of these things like the infrastructure and utilities sell-downs. We've also talked a lot about Transaction Banking mandates, markets performance, et cetera. So it's really being about strengthening the institutional presence overall. The other part, I'd say about this, and this is absolutely true of the institutional business and true to some extent to at least the top end of the business -- banking business, there's no such thing anymore as a domestic institutional bank. That is not the way our clients think. And so part of this has been to make sure that we've got the ability to serve Australian companies who are doing more overseas. And we've seen as part of that we've built what we consider to be more globally competitive capabilities and resources, infrastructure, transport and financial institutions. So we've had particular appetite in those areas, and again, that's happening over the last 3 or 4 years. Some of what we're seeing is a result of that ongoing investment, some of it is, as David said, certain more cyclical market characteristics, but yes were happy to keep investing in the business. I don't think the year-over-year increases in investment will affect. I know they won't continue to be as big as they've been historically just because the business is now closer to the state where we consider it would be a really good globally competitive institutional bank.

David Paul Craig

And just to answer your question on that stable funding ratio. Of course, when APRA makes comments, it makes comments about the average of the industry, so each individual bank will have its own story. But we've certainly modeled and worked through where we think we are in that stable funding ratio. We think we're well placed and we don't expect any material changes to our balance sheet when the rules are finalized.

Melanie Kirk

We'll move to the phones for question. We'll take the first question from Rich Wiles.

Richard E. Wiles
Morgan Stanley, Research Division

I'd like a follow up a question about the Institutional Banking & Markets division. [indiscernible] from volumes not necessarily [indiscernible] much revenue or profit [indiscernible] revenue doubt pre-provision profit. [indiscernible] I understand your comments are often [indiscernible] cost of capital. This will [indiscernible] in the loan [indiscernible]. indiscernible] benefit? Is there going to be great growth returns going through accelerated growth? Is it going core [indiscernible] ability. I just want to ask and we look more of benefit competitive advantage [indiscernible].

Ian Mark Narev
Former Executive

Well, Richard, you're cutting in and out of it, but I think the point that what we heard in your question was you're seeing the overall profit growth grows slower than the volume growth. And the question is, you understand the strategy, but what's it delivering in terms of returns to shareholders. It's a combination of a few things. Number one is that as a major Australian financial institution, we need an institutional presence. That's an important part of the strategy. I don't think it's ever going to be the business that defines Commonwealth Bank, but we need an institutional presence. And as I said before, this has been part of investing in it to make sure that it's a really strong Australian institutional bank, recognizing that any domestic institutional bank needs to do some degree of competition outside its borders to support its clients. What does it contribute to the Commonwealth Bank shareholder? Well, it comes back a little bit the discussions -- what Brett asked. it is producing returns that are above the cost of capital and, therefore, it's value-creating for the Commonwealth Bank shareholder. And critically, that's not just on the basis of current low loan impairment but on the basis that we measure this, which is the profit after capital charge. Now under any analysis of this business, the average return on what you're going to be doing in Institutional Banking & Markets is not going to be as high as returns in other parts of the sector. That's fine. It's part of an overall balanced approach to growing the Commonwealth Bank with its customers and with the people that we're here to serve. So as long as the business keeps doing what it has been doing, which is grow in a good risk-adjusted way and delivering risk-adjusted returns that are above the cost of capital, we do have the appetite to grow it. I can't imagine a scenario where in the near to medium term it's significantly reshaping the portfolio businesses or earnings or assets of the Commonwealth Bank. And it's not intended to.

Melanie Kirk

We're having some problems with the phone lines, so we'll move back to the room. So Catherine Offrey [ph].

Unknown Analyst

Catherine Offrey [ph], Whitestone [ph]. I just wanted to -- just interested in transparency with regards to this mining exposure. Firstly, on the actual price that you use in commodity prices.

Ian Mark Narev
Former Executive

I'm sorry. I can't quite hear you, Catherine.

Unknown Analyst

In terms of the commodity prices that you're using, is it spot or is it the long-term pricing curve? And then secondly, where you have like an impaired infrastructure asset that's relating to mining, I presume that's not in the gross mining exposures that you have. So if you have like an impaired coal terminal, for example, where does that show up?

Ian Mark Narev
Former Executive

There are different categorizations. So you can see on the different chart on Page...

David Paul Craig

113.

Ian Mark Narev
Former Executive

113. We've got things characterized in mining, oil and gas, and we've got other things in energy and other different parts. So in aggregate, you could probably add another $8 billion or $9 billion to everything related, give or take. Now the important part of understanding this in the context of the current market environment, if you look at for example, oil tankers, given the amount of supply in the market, the credit quality of a lot of the exposures in that part of the market has gone up and up and up for reasons that are obvious. The thing that's driving oil prices down is a glut of supply. And if you happen to be in that part of the value chain, things are going pretty well for you. So again, when you think about different players in different parts of the supply chain, there are very different characteristics of how these sorts of prices are impacting them. In terms of your first question, what do we use? We use a deck -- what we call a deck of prices on the different parts of each commodity. When we are originating credits at that stage, we are running scenarios and stressing the credits at the time of origination you would hope and expect we're doing. The interesting kind of counter-intuitive thought on that is one thing we need to be extremely careful about at the moment is making sure that when we're extending credit to people who are benefiting from the low oil price, we also don't assume that the oil price is going to be as low as it is forever. So you are always looking at different parts of the cost structure and different parts of the pricing structure when you're originating the credits. And we by no means have such a pro-cyclical approach that when we're originating credits or refinancing, we're making assumptions based on the current spot price. That would be a pretty dangerous way to run the business.

Melanie Kirk

We'll take the next question from Scott Manning.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. I just wanted to ask some further questions. Firstly, on the currency you've talked about -- the exporting [indiscernible] being a little bit better. But in terms of the stress tests or market volatility, what are you assuming in terms of potential significant currency de-ratings in the region, for example, and what that may do to volumes and confidence and the like?

Ian Mark Narev
Former Executive

A number of different factors here. I mean, we obviously do a bit of stress testing on what might happen with the Chinese currency. And I think the other really important aspect overall for the region, as Rob just said [indiscernible] talks about the impact that any devaluation of the renminbi might have on other emerging market currencies in the region. The reality is that, that counterparties who are dependent on those sorts of currencies is a very, very small part of our business. So although, again, in a similar question to Catherine's point, when we're originating credits, we're making decisions. We're modeling different scenarios on the currency. The sorts of immediate effects people are talking about in terms of the Indonesian rupiah, the South African rand, et cetera, the currencies that are most likely to be at the first order of effect for many Chinese devaluation wouldn't cause us a significant problem at any sense.

David Paul Craig

I might add to that, though, if you're thinking specifically about commodities, obviously, one of the protections that the Australian economy has is when commodity prices go down, the Aussie dollar usually goes down as well, so there's an offsetting buffer that plays through. And when we do our broader stress test, and we've done one in this period on commodities in general as a sort of a global commodity issue, we find that, that is one of the moderating impacts.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

And secondly, just on the growth in the institutional book from the drawdowns in that infrastructure space that you referred to, what's the timing duration of those lines? Are they longer-term 2 to 3-years facilities or are they simply timing differences [indiscernible]?

Ian Mark Narev
Former Executive

They vary. I mean, in many cases, the way these transactions are structured is the banks play an immediate role and then later on the sort of debtors are spun out into different parts of the capital markets. It varies very much depending on different transactions and the nature of the different counterparties. Sometimes we're taking holds for longer period; sometimes for a shorter period. There's a mix depending on the individual transaction. I don't know, Kelly, whether there's anything more you want to add to that.

Scott Robert Manning
JP Morgan Chase & Co, Research Division

So you might see a little bit of reduction in balances, but the corresponding capital will grow?

Ian Mark Narev
Former Executive

You can see. Yes.

Melanie Kirk

So we'll try to the phones again. We have Brian Johnson on the line.

Brian D. Johnson
CLSA Limited, Research Division

I have 2 questions. On Page 59 of the results, I can see there's another $86 million of income tax over provided in the prior year that's flowing through cash earnings. Can we get a feeling of both the quantum of the unrecognized deferred tax assets that you could realize and some idea about when we'll stop getting these material write-back gains coming through the cash earnings?

David Paul Craig

Well, obviously it's difficult to predict. Brian, as you know, we take a very conservative approach to all provisioning, including provisioning for tax. And so we are always erring on that conservative side. I've tended to -- I think the cash -- the tax rate, I should say, this time is 27.5%. We think it's going to continue to be in that region, maybe 28% next year, but that's still pretty much in the same area.

Brian D. Johnson
CLSA Limited, Research Division

So we should expect to see more of those tax recoveries from prior years coming through?

David Paul Craig

Well, maybe, I mean. But what I'm really flagging is that we're being conservative in our provisioning and we'll see how things play out with tax office in other places. But our forecast for tax rate for next year in aggregate would be about 28%. Obviously, the main factors that play through that are lower taxes in other regime -- in other areas where we operate. So almost all other countries around the world have a lower corporate tax rate than Australia.

Brian D. Johnson
CLSA Limited, Research Division

Okay. The second question is, in December we had APRA send a letter out talking about concerns ahead in the calculation of the stable deposits when calculating the lending -- the liquidity coverage ratio. If I look on Slide 115 today, I can see that your stable deposits have gone from $66 billion to $67 billion. We've also had APRA make a number speeches where they've spoken that the Aussie banks basically have got too much short-term funding and it will be challenging making that stable funding ratio, so we've got to lengthen that. If I looked at the slides today, we can also see basically the funding cost curve basically elevating. Is the fact that you may have to continue to lengthen that duration for those 3 factors, will that have a material impact on the NIM going forward?

David Paul Craig

So let me -- I'm going to ask Paolo to answer this in detail. But as I've said before, in our particular case, and obviously when APRA talks or sends letters out, they are industry-wide things and so, you can't draw a conclusion about individual banks from that. From our own perspective, we don't see any material change to what -- how we're operating, but I'll ask Paolo to give you -- to flesh that out for you.

Paolo Roberto Tonucci
Former Group Treasurer

Yes Brian, just to cover the first point, we have looked at the guidance from APRA and we've reflected that in our deposit numbers and it had a very small impact in terms of deposit classifications. In terms of the comments made by APRA about the net stable funding ratio and the reliance on short-term funding, those were Australia-wide references. And I think when you look at the position that the Commonwealth Bank is in, it's very comfortable. So we would not expect any meaningful change in terms of our funding mix from any further guidance from APRA in terms of reliance on wholesale funding nor indeed from the NSFR when that comes into effect in 2018.

Melanie Kirk

Right. We'll take another question from the phones. We have Matthew Wilson [ph] on the line.

Unknown Analyst

I was intrigued by one of David's explanation in the presentation, whereby the higher equity capital contributed to the lower NIM. I refer you to Slide 33. What's happened to the free funds effect?

David Paul Craig

Sorry, by free fund effect, do you mean the fact that -- so that -- if what you're referring to is the fact that we've got more capital and therefore there will be a favorable interest income, is that what you're referring to?

Unknown Analyst

Correct. Capital has no interest expense, so every dollar of capital will expand the margin.

David Paul Craig

Well, yes and no. So you're right in saying that there is a favorable net interest income impact on that capital, which of course, came in about halfway through the period, and that's had about a $60 million favorable impact in this period. But the offset to that is we then invest the capital to protect the balance sheet. So if you think about our balance sheet, our assets have a duration of about 5 years, an average duration of 2.5. Our liabilities, you can see from what we have, also have an average duration so they match at an average of about 2.5 years. So we then have an unbalanced balance sheet because, obviously, equity is the other component, and we need to consider how are we going to invest that equity.

We invest the equity for 2.5 years in order to ensure that -- on average 2.5 years, so 5 years with an average of 2.5, in order to ensure that the balance sheet is fully hedged. And it's that investment and the attractive earnings that we get from that investment, which are lower than the average return on assets on the balance sheet.

Ian Mark Narev
Former Executive

The other critical part to understand here somewhat ironically is when you raise the extra capital and invest it in the 5-year track with a 2.5 duration of equity, it's got the impact of making you required -- requiring you to hold more capital because of the interest rate risk in the banking book. So not only is it negative on the margins but you've got a slight anomaly here where you're raising more capital but needing to hold my capital because you've raised more capital.

Unknown Analyst

Okay. You present a very positive picture. Unquestionably strong, prudent underwriting, high return, reasonable EPS growth. But we haven't seen a slight dividend outcome [indiscernible] since December 2008, which preceded a substantial cut. Could you reconcile your rhetoric and metrics to the board's dividend decision?

Ian Mark Narev
Former Executive

Yes, that we've kept the dividend at $1.98 having raised $5.1 billion of more capital. I mean, the maths of it are pretty clear. When we're making the dividend decisions, when we're discussing it with the board, we're looking at the outlook on regulation clearly. We're looking at the outlook on risk-weighted asset growth, and we're looking at the outlook on credit quality. And what we have painted here today and shown through the result is that as we sit today, we're very comfortable with the credit quality in the book. However, we're a financial institution and we're leveraged to the external environment and we can never assume that the external environment won't affect us. We could -- all the trends at the moment are stable, we could be sitting here in 6 months' time and the world looks a lot better or it might not look as good. And so that's one of the things that we clearly need to balance, is making sure that we're trying to be very long-term focused in the decision. And whether it's in our profit growth or return on equity or dividend, never to try and get a positive surprise from the market on a particular result but just keep focusing on what's best for the customers and the shareholders over 2, 3, 4, 5 years.

David Paul Craig

Yes. And Matthew, I'll just call your attention to Slides 48 and 49 in the pack, where you can see that we've had an interim dividend of 70%, 71% in each of the last 4 years since we came out with our formal dividend policy. So the approach is to pay 70%, 71% at interim and then between 70% and 80% for the full year so that we tend to sort of pay, as you can see, around 81% in the second half or have done historically, hitting an average payout ratio for the last 3 or 4 years of 75%. So we intend to -- as we said at the time that we raised the capital, we intend to hold the policy of paying 70% to 80% for the full year. And I think that this is a pretty good flag from the board that they're comfortable with the way the business is proceeding.

Melanie Kirk
Great. So that brings to the end of our question-and-answer time. So thank you for everyone for attending, dialing in and joining us via the webcast.