Question and Answer

James Freeman
Deutsche Bank AG, Research Division

James Freeman from Deutsche Bank. I just wanted to get a little bit more information around the Business & Private Bank and also IB&M. So I look at half-on-half, there's actually been quite poor result, both the revenues line and also, the cash earnings line. Now I understand, obviously, markets have impacted the IB&M numbers, but even looking at the Business and Personal Banking numbers, I mean we've seen, obviously, some poor growth across most of those divisions. Just an idea as to what sort of drove that -- what were the key sort of factors driving behind that, and how that sort of outlook looks for the next 12 months?

Ian Mark Narev
Former Executive

Well, I think the overall system environment, James, in which those businesses operate has, as I said, has continued to be relatively subdued against those debt market context. If you look at what's happened in both Business Banking and Institutional Banking & Markets, the underlying lending momentum in those businesses is actually pretty good relative to the market. But the question we're all thinking about, and this goes back to my outlook, is what kind of increase we're likely to see in the market? Now that's been a topic of debate, as you know, for 2 or 3 years. When is the big push back in the Business lending coming? Our view in terms of the outlook, is that, that's likely to be gradual. I don't think we're going to see any immediate turn to the upside. But I think those businesses against that market have actually performed pretty well. On the deposit side, again, from a market share perspective and an overall performance, they've done very well, and particularly, in both Business Banking and IB&M relying on a strong technology platform they've got. But deposit margins have hit by businesses, and that's a trend that I don't see changing in the next 6 to 12 months. Again, it's going to depend really on where the market's at. The other factor that you've identified is markets, and that applies to both IB&M and Business Banking. Business Banking, the CommSec business, you can see in the numbers, held market share, held yield per contract note, but overall trading volumes have been pretty low, and that's impacted that business. Likewise, in IB&M, the half-on-half markets performance wasn't quite so strong. We'll see how that goes in the coming financial year.

Warwick Bryan
Former Investor Relations Contact

Jarrod?

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. Two questions, first of all, just on bad debts. Third quarter bad debt number was $228 million. That implies $268 million or thereabouts for the fourth quarter. The driver of that increase, because we have been seeing the trend of it going down, and then, looking forward, are we at the end of ever improving bad debts, and now the expectation is that bad debts grow, at least, in line with volumes, if not potentially, higher. And the second question, perhaps to -- for you, and financial system inquiry. We've seen the interim report. We've seen rating agencies, globally, put negative outlooks on Canadian, U.K. banks due to bail-in expectations. So I just wanted your views on the potential impacts of the financial system inquiry on CBA, and in particular, the major banks.

Ian Mark Narev
Former Executive

Well, let me speak briefly about credit quality, and then I might hand over to Alden. He can take your second question. In terms of the half-on-half, the biggest driver of the worst second half was about 4 relatively bigger accounts weakening in Business & Private Banking. These were all long-standing credits.

There's nothing correlated between them at all. So although, people who watch Business Banking say, look, there's always 3 or 4 that are going to affect any period. In this case, they have all quite unique, been in the books for a period of time, and we don't see that as any sign of systemic weakness. So that's a key part in terms of what happened, half-on-half. Particularly, in the Business & Private Bank, where you'll see the half-on-half nature is probably the weakest. Alden, in terms of how you look at the 16 basis points, you might not provide a view on that?

Alden Louis Toevs
Former Group Chief Risk Officer

It's been running in commercial about 16 basis points for some time, and we had a recovery -- or a reduction in that to about 14 basis points in the third quarter, and then, spiked up a little bit. But if you look at how low it is, just a few credits, and there are 3, in particular, that tipped in pretty quickly. Non-related to each other, in separate industries, you get a sort of a downward trend and then an upward trend, that is really not an indication of hitting the floor and rapidly coming off of it because it's too idiosyncratic for that. We continue to see small business, medium-sized businesses delever, consistent with -- it's a fragile economy, it's an uncertain thing. So there's no real trend that we see right now in the downgrades versus upgrades, which would be a leading indicator of extra need for provisioning.

Ian Mark Narev
Former Executive

In terms of the financial system inquiry. Obviously, we, like other players in the market, are spending a bit of time now, preparing a response which we'll give in a couple of weeks' time. Number one, I think the approach that the panel took with its first report was actually, a really constructive approach. So the idea of saying, here our observations of the industry, here are certain policy options to respond to and get different protagonists in the market to respond to those as a way of progressing the inquiry is very positive. Obviously, for the major banks and generally, across the banking system, one of the big questions that is being debated at the moment is too-big-to-fail capital levels, whichever banner you want to put on this question of what is the overall levels of capital that people are going to need to be holding. The answer is, obviously, a mixture of a number different things. Number one, what's going to happen with core equity tier 1 ratios? Number two, how is -- might bail-in debt look? Number three, what's going to be the role of hybrids and other tiers in the capital structure? All adding up to, what is going to be the overall right amount of buffer that banks have in the future environment? A lot of conjecture on a lot of topics on this from our perspective. There are a number of options still on the table. I do think that the panel is still very much in "listen and find out" mode. And our response, we'll be providing some views on current levels of capital and the optimal way to achieve the balance between stability and efficiency for the economy. It's too early to read as to whether the changes are going to be insignificant, material, very material. But I do think the panel is coming at the right way.

Warwick Bryan
Former Investor Relations Contact

Jarrod, please pass it to Craig.

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. Can you, please, make some observations about net interest margin trends, a really good performance, I would have thought from the group this year in terms of the stability seen in net interest margin. You are seeing there quite a bit of pressure in the corporate book. Asset repricing would appear difficult from here. You've seen probably, a bit more fixed rate lending on the retail side. Can you talk about, perhaps, the influences of liquids, holdings from here, which I think, were built up in the period, the replicating portfolio? And I would presume that funding costs may continue to have a positive influence on margin from here?

David Paul Craig

Certainly, Craig. Look, you've called out all of the factors, and there are many of them moving in different directions. I think the first point to make, at least, at the moment, is that each of those factors is having less of an impact, individually than they had at sort of the height of the GFC, for example. So we are dealing with smaller movements in all of them. It's always hard to predict at the end of the day. Without a doubt, the most significant factor that we can't predict at all is just degree of competitive pressures in different parts of the business. You'd know, I think, that we have a pretty good approach -- sorry, pretty good track record of not competing away margin for the sake of competing away margin. So we do very carefully watch that volume margin tradeoff. And in low interest rate environment, where there's not a lot to play with, it's even more important to be very careful about how we manage each competitive reaction. And so that's, I think, we're pleased with these periods' results. Flat result, I think, in a competitive environment is tough to come by, and that's certainly what we'd be striving for going forward, but it will be what it will be.

Warwick Bryan
Former Investor Relations Contact

Victor?

Victor German
Nomura Securities Co. Ltd., Research Division

Victor German from Nomura. A question on capital risk-weighted assets. So I noticed that growth in risk-weighted assets was lower than the growth in balance sheet. And it appears, as they're one of the drivers, is that your growth in standardized approach book has been -- we'll, it's actually declining, while advanced methodology is growing. Are you able to just elaborate on dynamics around that? I'm assuming some of that goes to what David mentioned about running down Bankwest book. Are you able to talk about trends going forward? Is there a more of that, that we should expect? And is that going to likely to lead to further capital improvements in future periods?

David Paul Craig

Well, I mean, the main driver of risk-weighted asset difference is when risk-weighted assets move differently to the actual volume of assets is that where is credit quality. So what we're really seeing and what you've seen across the board in everything to do with our credit quality, is credit quality is improving and that automatically leads to relatively lower risk-weighted assets. You've correctly called out that the reason standardized has dropped is because Bankwest's loans are dropping. And most of the standardized is just Bankwest. So the fact that Bankwest business bank is shrinking, and particularly, obviously, problem accounts in Bankwest business bank means that risk-weighted assets in that space are declining. So that piece of it, I think, is probably near the end of its story, in other words, a decline in the pieces to do with Bankwest. We'd like to see a rebound there, and we're nearly at the end of that legacy book. But as far as the rest of the credit risk-weighted assets are concerned, it's going to be a function of credit quality in general. And we all get to pick where that's heading.

Warwick Bryan
Former Investor Relations Contact

Let's go down to Jon, and then, we'll go to the phones for a couple of questions. And then, I'll come back to you, Richard.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. Another question on the margin, but more specifically for the Retail Bank. If you look at the NIM now is at 262 basis points, which is a pretty high number, especially in a post-GFC low interest rate environment. So going forward from here and also a medium-term view, is it sustainable to have a margin at 262 basis points in a Retail Bank?

Ian Mark Narev
Former Executive

I might give Matt a chance to proffer a view on that.

Matthew Comyn
CEO, MD & Executive Director

Look, there's been a number of factors that have influenced the margin improvements, some of that has been on the asset side. As you know, for some time, we've been growing above market in consumer finance, and there's some benefit from that, given it's a much higher margin product on the asset side of the balance sheet. Secondly, we've seen improvement in margins, particularly, in TDs and the savings book, that's observed through the market. I think we get a disproportionate benefit given our investments in core banking. And we've also deliberately shifted our balance mix more into savings and away from TDs. And as David, I think, mentioned, transaction accounts, we've had the best year we've had in terms of new transaction accounts as well. So I think, we're very comfortable with the margin performance this year, and it's, obviously, a very acute area focus for us going forward, as David said, around sort of volume-margin tradeoffs, and not participating in what's been some very aggressive pricing particularly, in the asset side of the balance sheet.

Ian Mark Narev
Former Executive

I'd add just 2 broader strategic points to what Matt said, Jon. Number one, is if you look at the waterfalls on margins, Pages 42 and 43, and you say, what are your assumptions on each, asset pricing, funding costs, basis risk, portfolio mix, et cetera? Good assumptions can go either way in sort of the near term. So the near-term margin trends is a good mix of things that could be quite positive with things that could be more challenging. In the longer term, there are 2 fundamental views that we've got as an organization. Number one, is you must have all your settings as if margin is coming down. It's the only way to run an institution in a competitive market. And that's one of the big drivers why we have pushed productivity so hard because we want to make sure that we've got a productive operating base which provides some buffer to our shareholders for structural margin decline. And number two, is, I think, the group's strategy over many years now, consistently, as David pointed out, has always been to balance between margin and volume. And actually, interestingly, you can see even in the ASB in this period, which has, historically, been an ongoing grower, saw the opportunity in business lending and has grown volumes quite well, but actually, pulled back home lending volumes a little bit, and they grew a little bit under system. So that, again, is a philosophy right across the group to managing the margin-volume tradeoff as a critical part of how we're going to continue to operate.

Warwick Bryan
Former Investor Relations Contact

I might go to the phones, Brian Johnson, CLSA.

Brian D. Johnson
CLSA Limited, Research Division

I have 2 questions, if I may. The first one was, if we have a look at Slide 97, we can see a decline in the usage of LMI. Could I get some comments as to whether, in fact, LMI usage will go down as you just charge a higher margin, given you no longer get capital relief? And then, also on Slide 102, can we get some comment on the assumptions on LMI recoveries, under that stressed scenario, that's one question. And the second one is, could we get some comment on the earnings gap created from the sale of the REITs?

Ian Mark Narev
Former Executive

Let me talk first about the first part of LMI, then I'll hand over to Alden about your question on Page 102. As you know, with the LMI over 80% is standard practice to insure loans with LVRs over 80% other than those, for which we charge the LDP, the low deposit premium. And those are actually, as you're probably aware, risks that we decided to keep on and not insure because the characteristics of the individual counterparty are very positive. And it's proven to be pretty good for us because we found that the LDP performance of the book is actually stronger than the performance of the book as a whole. So we do have appetite to do a little bit more of that, and that conversely, has some impact on the LMI numbers you see. The capital treatment of LMI has been consistent for some period of time. So we've actually never done it for capital relief. It never actually makes sense from a capital relief point of view. We've just done LMI because we think it's a belts-and-braces way, and it probably, makes us sleep a little bit better at night. In terms of the Page 102, Alden, the assumptions behind the LMI recovery numbers, you might want to talk to that.

Alden Louis Toevs
Former Group Chief Risk Officer

So the stress test that we use is given in the key assumptions in the upper right-hand corner of Page 102. And then, what we do, is we apply that to the -- all parts of the portfolio, including the portfolio that's insured. The insured portfolio stress outcomes, is then, taken to the LMI providers, dominantly Genworth but also -- well, in this case, it's RBS, so it's Genworth. Bankwest is covered by QBE. The portfolio is played through, and then, we look at the ability of Genworth to basically support and pay off of this on an assumption of, I think, about 70% payout, is that right, Fiona? Sorry? The insurance payout, our perfection [ph], if you will, of 70% on the dollar. So it's a conservative number in terms of the claim that we think that we will be paid by our insurer. I might also point out that APRA does not give us any credit for LMI coverage of the portfolio, even though there is a very real cover of loss against that portfolio. I hope that answers your question here.

Ian Mark Narev
Former Executive

In terms of the second question, I might hand over, Brian, to Annabel to respond.

Annabel Fitzgerald Spring
Former Group Executive of Wealth Management

Brian, just a really quick response on that one. Just looking at the numbers last year compared with this year, you will notice that the Wealth Management business actually made more this year than last year, even excluding the property business. So you can see that through organic growth, just in the Wealth Management business alone, in essence, we have already replaced the REIT income. And I think that's an important aspect, really, just underlining the growth of the Wealth Management business. That being said, as we looked to grow and continue to invest in the CFSGAM business, you'll notice also a significant investment and you'll see the expense of that investment, but you'll also see the outcome of that investment, with respect to opening in Dubai, and considerable also, building up of manufacturing capability, as a very conscious choice in that business in our more traditional asset classes.

Warwick Bryan
Former Investor Relations Contact

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. Ian, I want to ask you about the growth in the Institutional Banking. You said that volume growth was 4% in Australia, but 9% for the division. That obviously, implies very strong growth internationally, leads me to ask 2 questions about that. Firstly, we've seen what's happened to ANZ's Return on Equity from their expansion in institutional banking outside Australia. Why are you comfortable pursuing such strong growth? What does that mean for your ROE outlook? And secondly, in 2001, the Australian banks all had a lot of problem exposures from offshore institutional lending. At the time, most of the banks said that, that strategy was noncore and they stepped away from that. It seems that more than a decade later, you're heading back into that territory. So why are you comfortable with taking on the risk profile of lending to institutional investors offshore when that may not be core to your Australian franchise?

Ian Mark Narev
Former Executive

Richard, it's a good question. Number one, I mean, the 9% growth has a spot balance growth year-on-year for Institutional Banking & Markets, which is a good core growth here, and as you say, some growth overseas. Number one, I mean, in terms of our aspirations with this strategy, the likelihood that it will have any real impact on the group's ROE at that kind of levels, very low. The view that we've taken consistent with the capability -- capability-based strategy we've got generally in the group is that there are 4 areas we're based on the market we've been operating, and here, we think we've developed globally, competitive capabilities. Those are: infrastructure, transport, resources and financial institutions. So in those 4 areas, for various reasons, that's sort of part I give [ph] the answer. So it's very focused on the areas where we believe we've built capability and have been able to test that capability, and have got confidence to do it overseas. Number two is, we're making sure that from a risk appetite perspective and a risk process perspective, things are done in respect of that book, and this is primarily, in London, exactly as they've done in Australia, which means, Chief Risk Officers flown from Australia into the U.K., risk team built around the Chief Risk Officer, properly resourced. And again, real product capability in those areas and proper CBA standard risk teams, that's not -- we've actually resourced ahead of the business growth, not on a rubber band. And number three, the really unique aspect of this environment over the last few years, has been -- that as a AA-rated bank, with real capabilities in these areas, areas like infrastructure resources, et cetera, are real core to where the world is going. In environments like the U.K., whereas 10, 15 years ago, the global banks were all great ratings, and were able to compete, and therefore, you were picking up the detritus, here, over the last 3 or 4 years, we saw significant local players in Europe, significantly pull back. And that meant that rather than dealing with the people around the fringes, you were actually dealing with very high-caliber PLC counterparties in areas we knew well because they like that credit rating and because we're open for business. And that's enabled us over a few years to build a good business. Now to the extent to which the environment changes, the competitive environment changes, et cetera, our strategy will evolve to do it. So we're certainly not setting targets. If next year, there isn't good lending to be done, we'll happily have that lending come back year-on-year. But it's a considered strategy that's been executed over a few years, and we're very happy with how it's going.

Warwick Bryan
Former Investor Relations Contact

Mike Wiblin?

Michael Wiblin
Macquarie Research

Mike Wiblin from Macquarie. Just a question on capital, very strong. Can you update us just a little bit on how you're thinking about the appropriate capital level given, I guess, an 8% APRA ratio on the Colonial debt? And then, just a second question around investment, obviously, very strong on Page 44 there. Core banking disappeared, productivity and growth there, picking up the slack. Can you just talk about how much of that is actually, is take [ph] focused, and some of the things you're looking at? And what is the part for CapEx here? Is it -- it looks like it's trending down there a bit, but does it stabilize at some point, and is that just a cost of doing business given disruptors and the like?

Ian Mark Narev
Former Executive

Why don't I get David to talk about capital, and I'll take the investment question after that.

David Paul Craig

Yes. So I think, I know that different analysts at different times have challenged us to come out with a capital target. I think that the clear thing, so far, is there's no point in having capital targets because the rules keep changing. APRA is still clarifying some aspects even now of how the current rules are to be managed. And obviously, we have a financial systems inquiry. The board considers our capital level, obviously, very regularly. They look at the level that we're at, they look at the strong capital generation, and I feel very comfortable about where we are. So we won't be coming out with any formal targets, or anything until such time this is clear, what it is we're aiming for.

Ian Mark Narev
Former Executive

If I turn to investments and maybe look at the bottom right of Page 21, how much of it is technology investment? Well, number one, you can see that 11% of it is just ongoing in the branch network, that we've got now to 255 IDMs in the branches net. So within those sorts of numbers, you can even see technology in that. So even in the branch number, you're seeing technology being a big driver of what it used to be, just cut away a few counters and put a few licks of paint in the branches. The risk and compliance, it's a big spend, it's $300 million, roughly, for the year, that's going to continue. That has technology aspects to it, but I wouldn't describe that as being a technology spend per se. Though in some areas, for example, we spent a lot of money putting the catalysts, supervision and monitoring system in the financial advice business in the last 2 or 3 years. We consider that to be sort of pretty industry leading. And although, it may not feel like it to many people at the moment, from the point of view of those sorts of investments in the business, I think they will have strategic value. Then, that bottom of 65%, to me, I mean this is just part of what the bank is going to need to be forever now, which is a technology innovator. And the environment that we're moving into, having got the stable platform of SAP and core is what we describe as a lot more creative destruction, a lot more test and learn, so you've got world-leading innovation like Kaching a few years ago, which gets superseded by the CommBank App, which after 7 months, has 2.3 unique users on it -- 2.3 million unique users. And this is going to be an ongoing part of how we operate as a bank. You can see it in the character of the executives that we appoint. You can see it in the investment profiles. Critically, we've also got to make sure that the way we account for all this reflects that new reality. So we write off everything under $10 million is now capitalizing off it. We've got a pretty aggressive -- sorry, conservative capitalization policy. You can see in the materials relative to other major banks, our levers of capital software are actually quite low now. And we're going through a process where you can, again, see in this half and the previous half, we're taking a more aggressive approach to looking at capitalized software levels, looking at amortization levels, and taking the hit where we think things are out of date. This is now going to be the way the bank operates over the coming years.

David Paul Craig

That should be really clear. There's no way investment spend is declining. I mean, this is, again, forever.

Warwick Bryan
Former Investor Relations Contact

Andrew, Tim, did you have questions down the front here? Okay. Brett? Sorry.

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

A simple one on the volume of expenses for Colonial First State. You commented that they increased a lot, but you didn't tell us why. Could you give us the reason for the increase? They went up 30% from 2013 to 2014 financial year, while the income increased by 10% over that period.

Ian Mark Narev
Former Executive

Annabel, do you want to take that?

Annabel Fitzgerald Spring
Former Group Executive of Wealth Management

I think looking at the expenses, just on Colonial First State, you can see a number of different trends. You can see the ongoing expense of compliance and regulatory reform. You can see continued investment in the business, and you can also see some element of the compliance spend associated with the advice business.

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

The volume expenses?

Annabel Fitzgerald Spring
Former Group Executive of Wealth Management

Volume expenses. The volume expenses, in particular, if you can see the change there, that is, in particular, with respect to the advice business, any distinct change in that.

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

Yes, it is. But why did they increase so much? Presumably you've increased commission rates, would that be right?

Annabel Fitzgerald Spring
Former Group Executive of Wealth Management

It's with respect to the change in the advice business, so the expenses have increased.

Ian Mark Narev
Former Executive

Faster than the volumes in the business here.

David Paul Craig

The cost of -- to be very clear -- I mean, the cost of doing business -- giving advice these days, particularly, for us, is much higher than it used to be.

Warwick Bryan
Former Investor Relations Contact

I have one more question on the phone. So Brian, you're on again.

Brian D. Johnson
CLSA Limited, Research Division

I apologize if I keep on rambling about stuff. In the RCAP review, the Basel [ph] -- Australia was largely compliant. But one of the things I called out, you said residential investment property lending should perhaps, to be treated as commercial property lending. So when we talk about internationally harmonized numbers, I was wondering if you could share what is -- what that would do to those same comparatives.

David Paul Craig

We're -- well, the answer is a little bit, Brian, but I'm surprised you didn't call out the large number of items that went the other way. So I think that, that particular point was worth about 25 basis points. But there were about 120 basis points of other things that you forgot to mention going favorable to us in the RCAP process. I'm glad you're getting into the detail.

Warwick Bryan
Former Investor Relations Contact
Thanks, Brian. Any more questions in the room? If not, we'll close out the day. Thank you very much for coming. It's great.