Question and Answer

Cameron Anthony Clyne
Former Executive Director

Just the usual protocols if you wait for the microphone and state your name and the organization you represent. Why don't we start with Jon?

Jonathan Mott
UBS Investment Bank, Research Division

A question on the -- a question on the Personal Bank record. If you just look at this performance over a number of years now, sort of 3 years or so with the strategies been going, with the change in strategy. Over that time, profitability's been broadly flat but the balance sheet has grown by about $55 billion. And the return on assets has fallen from 95 bps to about 65 basis points. So it's come under a lot of pressure. I understand you can leverage the business output and its family mortgages to the ROE hasn't fallen this far but in the funding constrained market, it still uses a lot of funding and obviously it's expensive to do that. Are you happy with the returns there and at what stage do you think you need to readdress the pricing strategy and the strategy as a whole in that Personal Bank?

Cameron Anthony Clyne
Former Executive Director

We're very happy with the Personal Bank. I think you've got to go back 3.5 years ago to where we were. And this -- we look at the business very much on an enterprise-wide basis and how each of the businesses contribute to each other. We're in a situation 3.5 years ago with a Personal Bank with bottoming customer satisfaction, was not gathering deposits, was growing poor quality mortgages at half the system. Now that situation, if it was allowed to persist, would begin to threaten other parts of our franchise. We would start to have issues where we couldn't grow because we weren't writing deposits. We couldn't grow because we're getting balance sheet concentrations. The external environment at that time was also where you had substantial government support into the mortgage sector. You had mergers that had occurred in banks that were stronger. So we only had one opportunity and that was to undertake a radical organic strategy and we think it's absolutely delivered. We've improved customer satisfaction. We've substantially improved deposit gathering capability. We've stretched that into a cross sell relation with our higher ROE products. It has delivered substantial benefits to our Business Bank by improving the balance sheet. So we're very comfortable with the Personal Bank strategies at this point in time. It's not to say that we won't continue to review them, but it's been a very strong delivery to the outperformance over the last couple of years.

Unknown Analyst

Just on -- a question probably more so for Joseph in terms of just the Business Bank. Just want to get a sense of the competitive dynamics you see in the market in terms of just margins and you do seem to have a bit of repricing coming through in February, but I just wanted to get a sense -- you might have heard some competitors make some noise about wanting to expand market share in that segment and just trying to get a feel for your growth aspects. And not just the fact as well that in terms of the economic forecast. Business Banking is not expected to really pick up as quickly as mortgage growth is. Just wanted to get your sense of what you're seeing in terms of the outlook there as well?

Unknown Executive

Just on the second question around outlook, we are cautiously optimistic. The issue really is around business confidence. And when we see business confidence starting to pick up and obviously we'll see activity because it's been a period now of almost 3 years, if not longer, of below system level of investment outside the resource sector. So we do see when confidence turns, that we'll see an uplift in business activity. But the outlook as Mike mentioned right now is somewhat more conservative in terms of our expectations. On the first part of the question around competition, no real change from last half. I mean the intensity of competition is as high as I've seen it with all of the major banks seeking to grow their business lending share particularly in the SME space. And that appetite for business lending, of course, is into a market with a subdued level of activity. So it doesn't mean that there's a lot of pressure on price and increasingly in some segments of the market, we have seen some relaxation in credit standards. So our approach is to be very disciplined around how we are pricing and the risk -- level of risk that we're taking. But the level of competition remains on quite a high level and we expect that to continue as other banks seek to grow the business share.

Jarrod Martin
Crédit Suisse AG, Research Division

Jarrod Martin from Crédit Suisse. A very strong capital outcome this half and I note that you've had $9 billion of RWA optimization within that outcome. You've said that looking forward, you think you'll get 8-plus percent. We heard Westpac last week say that Core Equity Tier 1 that would there or thereabouts from there just below 8% at this point. So what's your view on further risk-weighted asset optimization and then ultimately, when is enough capital enough and what you do from there?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, I mean, hopefully the optimization will continue. I mean a lot of it is coming from housekeeping. We didn't really have our -- NAB, as I've said before, late to qualify for Basel II and so the sophistication of its models, for example, is not there. So we continue to work on things like models, like collateral matching as we improve our internal processes and these things bring down RWAs. So we -- every time we deliver something, we refresh our agenda and we go off to get some more. It won't necessarily always be at the same level. You will get some diminishing returns, but we are hopeful that, that will continue to contribute going forward. As to the level, we need to see both exactly where the regulator wants to sit, where the board wants it to sit, where peers sit. As we've said, our sort of interim target self-imposed was to get to 8% and then see where things settle out, depending on, as I say, were others settle and what's appropriate given likely volatility in that measure and so forth. But -- so we set ourselves the target of getting to 8%. I think we'll be above 8% around September or soon after, but certainly by the time the second bridge converts. And then I think we'll reassess at that point.

Jarrod Martin
Crédit Suisse AG, Research Division

[Question Inaudible]

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Sorry?

Jarrod Martin
Crédit Suisse AG, Research Division

What do you do after that?

Cameron Anthony Clyne
Former Executive Director

We diligently manage capital. We can't announce the buyback date just yet. I think we're not quite there yet.

Unknown Executive

Okay, Victor?

Victor German
Nomura Securities Co. Ltd., Research Division

Two questions if I may. Firstly on expenses. You've highlighted there are some additional expenses coming through and you're looking to continue to invest. You delivered, arguably, superior expense performance to your peers so far over a number of periods. Do you think you can continue doing that given that additional expenditure coming through. And also on the provisioning, if I look at Slide 90, your specific provisions slide indicate net write-offs were around $500 million, whereas on a group level, in the disclosures, it was closer to $1 billion. So I'm assuming there's some write-offs that have been incurred that haven't necessarily been already in the provisions and you're effectively near the top ups and you're suggesting that there's some of it coming from U.K. exposure and SGA. Given that both U.K. issues and SGA issues have been known for some time, do you think there's some, or perhaps not enough, conservatism in your models? And which will affect their lead to additional provisions if you need to take, in excess to what's really been provided for the lines that you've known?

Cameron Anthony Clyne
Former Executive Director

I'll let Mark talk to the provisioning. On the expenses, I think -- we took a view a couple of years ago that we had to manage expenses very tightly, but we needed to do it in a sort of methodical fashion, because we could see a number of challenges. One is that we are building up with the replacement technology is that the replacement accelerator, which we're very pleased about and will ultimately drive some efficiency while building up, clearly, a depreciation issue you've got to deal with. We're not going to win the argument that just because we're replacing 40-year old technology we can depreciate it on a same time scale. So that was clear. But the other thing was that we can see a subdued revenue outlook and so we thought that a diligence on the expenses would help us deal with that future depreciation as well as the subdued revenue outlook. And the reason we're being quite methodical about it is that it is actually important that we don't have a big sort of lumpy or jerky expense adjustments -- suddenly panic and say we've got to drive it out. And what's been pleasing is our employee engagement is actually continue to improved quite markedly as we've sort of dealt with it methodically. Can we keep up? Well, we're pretty much a cultural phenomenon now that we manage expenses very closely. Other than that, technology investment, we don't have big expansion goals that would necessarily drive the expenses. But the depreciation thing hasn't gotten any better and the revenue environment hasn't necessarily improved. So it's going to be difficult, but I think it just underpins the approach we've taken over the last couple of years. We've just got to keep going at it in a very methodical fashion.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

And then on the models, I didn't mean to throw the risk organization under the bus and say that we're completely inept on this front, but our models are -- I mean they're perfectly adequate, but they're improving. And that does lead to some -- a lesser requirement for collective provisions in particular when you see in fine detail exactly what your risks are. And as to the specifics, we are focused on keeping things moving through not having them sit in impaired and wrapping them up as quickly as we can. And that probably gives rise to volumes that you're seeing on Page 90.

Unknown Executive

James?

James Freeman
Deutsche Bank AG, Research Division

A question for Mark and then one for Cameron. Mark, just if we could get an idea of sort of how the margin's -- how the margin is sitting at the moment just sort of post balance date [ph], is it materially below where the average was for the half? And then Cameron, I noticed in the outlook the focus is to grow deposits and maintain margin. No bank has been able to do that to date, just sort of interested how you plan to do it. And given the competitive environment, we've got Westpac saying the same very strategy and turn deposit rates at very high levels. How you can grow deposits and maintain margin at the same time without some asset pricing. Is there anything you can do on the liability side?

Mark Andrew Joiner

Former Executive Director of Finance and Executive Director

Well, the ever elusive exit margin. It's impossible to say and the more you shorten the period, the more volatile a margin can be and I'm not quite sure when our last mortgage increase kicks in but that day our margin will be better. But what you have is just an inexorable 5 basis points a quarter rise in the average cost of homes. And then you get these step functions in the repricing. So we don't measure it over such short periods. So I couldn't tell exactly what it was in the last week prior to results of this week or anything else. But I can tell you that it's a challenge to maintain it at the current level because you constantly have to be out there in the newspapers and talking to customers and whatever and keep that flowing through if you want to preserve that. So it's very clear what the challenge is. It's a case question of execution.

Cameron Anthony Clyne
Former Executive Director

It's a pretty difficult aspiration. We've got at -- we have to -- that's our -- what we manage to is we're trying to improve our deposit coverage. I think we look at deposits for a couple of reasons [ph]. We appreciate everyone's out there competing for retail deposits. We are pleased with our track record. I mean you'll see there on Slide 29, we've had 78% growth in Personal Bank and 11% in business over the last 3 years so there's a track record there. We are raising more deposits than we're lending at the moment. We look at it through 2 lenses. One, is we are very focused, as Mark said on the quality and the qualification of those deposits from Basel III. We can scoop up lots of deposits to improve the ratio. But we have very focused in certain segments and we'll tend to sort of pay in those segments and be less sharp in others because that's going to be quite important when we do convert and the value of those deposits are determined. It also applies to, I know there's always a lot of skepticism around the issue of cross-sell but what we have done is, is used the increasing relationship platform in business and in the Personal Bank to deepen those customer relationships and that's being quite helpful. I mean the mortgage growth has come with very substantial transaction account growth and that's been quite helpful as well. So I think if we continue to push down that, down that path that will help. I guess the final point is we are increasingly deploying more of our new technology platform. And that provides quite a solid way of gathering deposits and particularly at lower cost. So I think the aspirations there -- we realize everyone is sort of fishing in the same pond. But I think we've got a couple of things that will help us achieve it.

Unknown Executive

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

It's Richard Wiles from Morgan Stanley. Cameron, the line losses were down in the Business Bank but during the half, the RBA has been forced to cut by 100 basis point. They are clearly less optimistic about the economy. Your arrears in the Business Bank were up in the half. So could you please comment on how comfortable you feel about credit quality now relative to 6 months ago? And also, please explain why the -- or what's driving the increase in the arrears in the Business Bank? Is it housing? Is it commercial? Is it SME?

Cameron Anthony Clyne
Former Executive Director

I'll get Joseph maybe to comment on the arrears but this is an extraordinarily difficult economy to read. So in the sense that the underlying fundamentals are actually quite strong. I would interact with dozens of our Business Bank customers every week with Joseph and others and you get a markedly stronger picture of the economy than you would get if you read newspaper headlines. But confidence is low and of course, so that's why it's difficult to read. Do I remain comfortable about the outlook? I do at this point in time, but confidence hasn't improved. It's probably got worse over the 6 months and there'll be some point when in fact that will tip in. Now the unemployment numbers will be out -- well they are out now, I've just seen them. If they're not good, then of course that just plays into the confidence issue. So it's a pretty fragile outlook I'd have to say, but if you took a snapshot standing here today, the economy and our

Business Bank customers are actually performing quite well. But in a very, very fragile environment. Do you want to talk about the arrears there, Joseph?

Joseph C. Healy
Former Managing Director of Institutional Banking

Sure, I'd be happy to do so. I mean the arrears position reflects the economy and it's largely in SME. It does include housing as well. There has been an uptick in the level of arrears in the Business Bank housing book but that reflects the fact that that's correlated to the performance of the SME book and that most of our housing lending is to SME customers. So there has been an uptick there. It reflects what's been happening in the economy. But we are comfortable with where it's at. It's in line with what we expected to see given the economic environment.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

I might just add that if you look on a pcp basis, the retail arrears are pretty flat and the non-retail arrears are down about 20%. So again if you take a decent period, it's trending in the right direction.

Cameron Anthony Clyne
Former Executive Director

I think we have a call on the phone.

Operator

[Operator Instructions]

Cameron Anthony Clyne
Former Executive Director

No, we don't have a caller. Brian?

Brian D. Johnson
CLSA Limited, Research Division

Brian Johnson, CLSA. Two questions if I may. Mark, the decline in the diluted cash in government bonds that we've seen, the liquidity with a big uptick we saw on the September half-year, was that something that was executed right towards the end of March or was it -- did we get a full run rate impact of the reduction in the diluted liquidity in this quarter or do we get it in the next one? And the second one is if you have a look on Page 98, the emerging new impaired assets are about just a whisker over $2 billion? But during the narrative, you were saying that in the second quarter it was below the first quarter, would there be any chance that we can get quarter-on-quarter split just to get a feeling of what was happening on the exit run rate on the rate of new bad loans coming through?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well on the second one, I'll look at that. I don't -- I'll just check we're not crossing some line on disclosure and if we can tell you, we'll tell you. And as to whether there was any -- Eric, can you tell me if there's any late period swing in the liquidity or...

Eric Williamson

[indiscernible]

Unknown Executive

Yes, we did do some reshaping around the liquidity but it was on the -- after December. We did see some opportunity to pick up some bank paper. And we did reduce our semi government holdings, which would be in the bucket you're referring to. So that was changes in the portfolio.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Second quarter.

Unknown Executive

[indiscernible]

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, you would only have got 3 months of that.

Cameron Anthony Clyne
Former Executive Director

Craig?

Craig Anthony Williams
Citigroup Inc, Research Division

Craig Williams from Citi. Doing the math on Page 139, of your release, if we strip out the life insurance liabilities and the other liabilities, your deposit funding seems to be about 51% of your total liabilities and equity. And your short-term wholesale funding is somewhat in excess of 20% of that balance as well. It seems to be finding a larger liquid position than your peers have. So some of your peers are closer to the 60% deposit funding and 15% short-term wholesale. Given the direction of Basel III, do you think that the required shifting, your liability mix, will be a challenging headwind to your relative revenue growth as you move forward? And in the event of a crisis, do you want such a large short-term wholesale funded balance sheet and consequently, having to dispose of liquids under these circumstances presumably that could also bring about a risk of contagion to your other funding arrangements. So what are your considerations around setting things up in this manner?

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Well, obviously, I mean the stable fundings of 85%, we need to recut that on an NSFR basis but broadly we've got the same sort of challenge under either scenario about 15% of our assets are effectively funded short although a big chunk of that is actually term debt with less than 12 months to maturity. And that's something we need to continue to chip away at. We've chipped away over the last 5 or 6 years, we've probably come half the distance we need to go and that's a the challenge for the Australian banking sector, it's not a NAB challenge.

Unknown Executive

Mike?

Michael Wiblin
Macquarie Research

Mike Wiblin from Macquarie. My question is really, perhaps for lease, just on the retail strategy. If you have a look at it I guess you're generating a little bit less from brokers these days marginally, move back the system on mortgages as well and we've seen a big decline in UBank interest rates. Can you just comment a little bit on some of those moves and the changes? And how they're factoring into the longer-term strategy in that business?

Cameron Anthony Clyne
Former Executive Director

Yes, I'll all take bank leases, I've got a personal issue there. Look, I think the transformation that we went through in the retail, it's a multi-year transformation, it can only be done organically. And the important thing, as we get into some of the longer-term issues there, which is sales force productivity, reconfiguring our store network, driving the technology changes. It had to be done off a franchise with momentum, which it has. We also had to -- we also wanted to ensure that we dealt with any future risks with regard to consumer action. And we still remain very confident. Everything we've done on fees and other things have insulated that business substantially relative to peers and what's coming. And you only have to look at what's going on in PPI. The consumer and pressure for social dividends has not ended. That's all dealt with and we've taken that hit and washed through that. So there's a lot more to be done in the Personal Bank quite clearly, but had we not reinvigorated that franchise, the longer-term things we need to do around things like sales force productivity and reconfiguring the store network, the investments we're making technology in digital and other things, it would've been academic, by and large. If you look back at the environment that we were faced with 3.5 years ago when we started it. On things like UBank, I mean UBank has been very helpful for a number of fronts. It is a brand that attacks a different segment of the market. It's been very effective in deploying and showing new technology, which is important. But 85% of its customers remain new to net. So the cannibalization is very low. So it's been a very attractive segment and one that we think we increasingly are learning a lot of from in terms of efficiency, given its low-cost channel. So it's a very important component of our strategy. So Personal Bank is still on a journey, but I would much rather be in the -- have the Personal Bank we've got today than one we had 3 years ago, that's for sure.

Unknown Executive

Brett?

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

Brett Le Mesurier with BBY. When we take out trading income, your income sale from the second half '11 to the first half '12. Does that tell you that the days of gaining market share through having a low price are over and that, as you mentioned in your outlook statement, the focus now has to be on ROE rather than gaining market share?

Cameron Anthony Clyne
Former Executive Director

Well, I mean I think the -- first of all trading, I mean, trading income is legitimate, to include, all banks do it. I mean we're not just different to any other bank in that. So you can strip [ph] the income out of everyone's business, then you can make that comparison. Usually the thing is, the assumption is that we're the only bank that's ever used a price lever. There's been some extraordinary pricing going on in this market, in the businesses. You just need to see someone comment I was surprised to having mortgage growth. Well if, you're discounting 115 basis points under the table, you're going to get mortgage growth. So I mean pricing is just going on across the board. We just happen to actually use it as an externally label [ph], which is being great, and that's why we've got 650,000 new customers. So it's a dynamic of the market. You've got everyone racing around trying to get deposits and you got weak volume growth. Price is going to be a feature. We just happen to talk about it because it's a factor. Everyone is doing it. That's a nature of the slow growth market.

Unknown Executive

Scott?

Scott Robert Manning
JP Morgan Chase & Co, Research Division

Scott Manning from JPMorgan. I just wanted to have a chat around dividend policy going forward. If you look at the current construct of earnings, obviously, revenue growth is harder to come by, pre-provision growth's kind of struggling and then everyone can choose their own adventure [ph] on the outlook for bad and doubtful debts, which will obviously have an impact on cash earnings. Now that you're at the level of capital that you will need to be post the conversion of the instruments, can you just talk to us about the importance of the dividend, sustained the dividend, growing the dividend, inflating the payout ratio but acquiring it back through a bigger DRP discount? Ultimately, the dividend yields on banks talks to what's ultimately looking attractive relative to rest of the market at the moment. So I think dividend is the key.

Cameron Anthony Clyne
Former Executive Director

Yes. We don't think 7% plus [ph] sequential in pcp and pre-provision growth is struggling, certainly not relative to the market. We think it's pretty good. It's better than 4%, 1% which we've seen in the recent reporting period. But on the dividend, I think we feel comfortable with where -- I mean, where it's at. We don't -- the important goal and we're able to obviously increase it slightly in this half. The important thing for us is that we want to be clear and always as quickly as practically possible about what we think is going to be the Basel III level with the [indiscernible] that we'll determine. At that point, obviously, we'll start to revisit how we manage dividend policy at that point in time. But in terms of payout ratio and the capital we generate, we feel quite comfortable with that dividend position at the moment.

Mark Andrew Joiner
Former Executive Director of Finance and Executive Director

Yes, we're at 71 payout. Now our sustainable payout ratio is much higher than that. But we have to wait and see what happens to market volumes and things like that. I don't think you want to be raising your dividend up and then you decide to grow with the market and you have to start cutting it to sustain the capital or having diluted DRPs and things like that. But once we hit our target ratios, probably the first thing to go would be discounts on DRPs and things like that. And then as Cameron said, maybe you do some buyback or maybe you'd raise your payout ratio if you think that the position is likely to be sustained. So that's all decisions to be made starting probably in 6 to 12 months from now.

Unknown Executive

TS, last question.

T.S. Lim
Bell Potter Securities Limited, Research Division

TS from Bell Potter. Are you still optimistic about the outlook in Northern England and Scotland. I thought the prospect would be as gloomy as the weather there?

Cameron Anthony Clyne
Former Executive Director

I'm not going to make the mistake of one of my predecessors on commenting on the Scottish economy. But I think, look, let me just make this in a broad sense. We are clearly not happy with returns in the U.K. and I'm very aware that it's a driver, if not the most significant driver of the discount on that stock. So clearly, we have been very focused at every opportunity if we can find a way to reverse that situation. We're absolutely attuned to it. But we made 2, I guess, clear commitments when we put our strategy out. The first was that we've got to focus on Australia. We want the Australian franchise to be as strong as possible. Now If I had a choice between a weak U.K. and a weak Australia, I'd pick a weak U.K. because Australia and New Zealand are our core markets. And we didn't want to have anything that was going on over that last 3.5 years, distract us from the Australian franchise, and this Australian franchise is clearly stronger now that it was 3.5 years ago. At some point, the U.K. will resolve itself one way or another or return from a returning profile in that thing. We don't want to then turn to be renovating the Australian franchise. We didn't want the true value of what is, I think, a pretty strong Australian performance in this environment to come through. So we have demonstrated, I think, through the SGA and the SCDOs that a considered management of legacy issues, these are better outcome. We could've maybe said take the testosterone approach and right the SGA. That would have been 4 billion and that starts to get you in a rising capital. We've got to just -- we've got to work our way through it. And we'll work our way through it, it will be a better outcome for shareholders. But what we will continue to do is not let any of that distract us from the quality of the core franchises. So the U.K. is in a difficult situation, its economy is 4% smaller now than it was in 2007. The Australian economy is 7% larger. So it's going to be a difficult environment. But having said that, the option that applies our brands. We have very strong brands, when we had the 3 [indiscernible] riding downgrade and we had to turn the deposit issue on, those brands attract deposits. There are quality brands in those markets so we do feel to be applying in markets that have been in for a long time. You've got some insulation against the economy. The economic outlook there is not good, clearly.

Unknown Executive
On that note, it is a pretty good place to end the proceedings. Thank you for attending today.