Question and Answer

Operator

[Operator Instructions] Your first question is from the line of Jon Mott from UBS.

Jonathan Mott
UBS Investment Bank, Research Division

Just got a question on -- it's actually Page 20 of the 4E [ph], I should say. I just looked at the lending and also the approvals. And you can see on the top line there that in the second half, resi approvals actually fell by 13%, and this goes to the comment at the very end of your presentation that you're not going to pursue unprofitable growth, which I understand. But given the repricing that was seen in the resi market over the last couple of weeks, are you now in a position to get more aggressive and to try and start lending to grow the balance sheet again? And what are the areas you are looking forward to try and start reaccelerating the balance sheet growth?

Michael John Hirst
Former MD, CEO & Director

Look, I think that's a reasonable assessment, Jon, of how we've seen the situation. And the pricing was probably at a level where we couldn't, given the capital that we had to apply to those loans, write business that we considered to return us a reasonable level. So with the repricing that's taking place, and there's still a little bit to settle on some of that I think, and there's been different approaches taken by different organizations, those prices are certainly coming back towards the prices that we have had out in the market. So we're comfortable that we can make a reasonable return at those levels. And then it comes down to why is the customer going to choose you over somebody else. As long as you can be in the ballpark on that pricing, we're pretty comfortable that our value proposition will take us forward, and I think we're already starting to see some signs of that.

Jonathan Mott
UBS Investment Bank, Research Division

Just following on. One of the issues that you had is that of the 2 state economies reversing, and really New South Wales is probably the strongest state at the moment, it looks like it's going to be for a while. It's also the state you have the weakest positioning. Do you need to bulk up New South Wales? What can you do to improve your position there?

Michael John Hirst
Former MD, CEO & Director

Look, I think that's a fair question, and we've always had some competing views around the answer to that. One is that, yes, it's the biggest economy and it's important that you should be there. The other view is that, actually it's the most competitive part of the economy and prices are a real driver in that space, and so you need to balance that out against those 2. Obviously, we're a third-party business. We do, do some reasonable mortgages and business out of New South Wales. But I think the Alliance Bank model is a real opportunity for us to increase our presence in New South Wales. And we have got one credit union that joined from New South Wales, and the growth that they have seen over the last little bit has been good. So we hope that there's some opportunities there to grow that further.

Operator

Your next question is from the line of Craig Williams from Citigroup.

Craig Anthony Williams
Citigroup Inc, Research Division

Can you talk about the increased provisions you've taken for the Great Southern portfolio? Is that a case of underestimating the willingness and ability for the professionals who had undertaken this finance in the first place? What sort of driven the need for a top-up that you've designated at this this period?

Michael John Hirst
Former MD, CEO & Director

Well, Craig, I think it's a couple of things. One is it's the experience that we have had over time with bankruptcies and things, but probably more to the point it's just that we're still in a position where some of the individual circumstances are unknown. So we, to some degree, have a bit of a finger in the air around some of this stuff, but we think that at a 10% collective against the outstanding loans, that's a reasonable level of protection for us going forward. Even with the bankruptcies, one of the things that we're finding is that people bankrupt themselves. We'll replace their trustee, and we'll find plenty of assets that can help solve the situation.

Craig Anthony Williams
Citigroup Inc, Research Division

So I'm a bit unsure then as to why you're still arriving at the view that you need to top up if you're finding that these borrowers, which you've indicated on balance are relatively well heeled, actually do have the asset support.

Richard Fennell
Executive of Customer Banking

Craig, it's really just a conservative approach to the situation. There were 3,300-odd borrowers, that's down to 2,600 or something. But that's a lot of people to work through.

Operator

Your next question is from the line of Victor German from CBA Equities.

Victor German
Commonwealth Bank of Australia, Research Division

I was just hoping to maybe get a little bit more insight into margin trends. As you talked about earlier, the book is not growing particularly strongly. I understand all the comments around your funding mix. Just wondering whether perhaps you can give us a little bit more color in terms of the outlook on margins. Obviously, you've given -- you've had some repricing and we've seen some repricing across the industry on the mortgages side. I know in early periods, sometimes when you have reduction in interest rates, that impacts your monthly margins and then as term deposits sort of reprice, you get the margin kick up. Is there anything like that, that may happen in this half that could benefit your margin going forward?

Richard Fennell
Executive of Customer Banking

Yes. Good morning, Victor. Look, the challenge with these most recent ones is we haven't seen the -- as significant a drop in the market pricing of term deposits because they're getting to such a low level now that I think people are realizing to retain those deposits, then there will be a need for a certain level of price to be maintained to keep those deposits in place. Now we're constantly monitoring our deposit flows. What we are seeing is continued very strong month-on-month flow into at-call deposits. And in particular, those 2 accounts I've mentioned during the presentation, the retirement savings account, which is linked to the government deeming rate. Now if we get another change in that rate set by the government, which we'd be hopeful there would, that would certainly have a positive impact. And also the EasySaver Account, which is -- if we see money flowing from -- heavily from term deposits into those EasySaver Accounts, which is set at 25 basis points below the cash rate, then that has a positive impact. But this is going to be a bit more of a slow, gradual grind I think on the deposit pricing side of things, particularly when we've seen increases in wholesale funding prices over the last few months. That means, I think, there's less rush across the industry to try and push TDs lower when the reality is other funding sources aren't any cheaper. On the asset side, we haven't made any decision around moving our investor lending rates at this stage.

We've been growing below system in that space. We'll look to monitor very closely what happens from a volume perspective to make sure we stay below the 10%. And if we need to increase our pricing in that space to stay below the 10%, then we'll do that. And obviously, that would have a positive impact. But what we'd rather do right now is sit back and watch to see how things settle and see if this gives us an opportunity to get that more towards system growth rates in our investor mortgage lending space.

Victor German
Commonwealth Bank of Australia, Research Division

And just one very small point of clarification. I think, Richard, you mentioned that with respect to Homesafe, you revisited your assumptions around future price growth. Excluding revals, what do now assume for that portfolio revenue contribution? I think in the past it was $12 million per year, wasn't it?

Richard Fennell
Executive of Customer Banking

Yes, well, if you have a look at the last 12 months, that's -- that was over $16 million -- $16.6 million. Look, we would expect that -- something in the order of that again, probably rising a little bit, assuming the portfolio continues to increase, and we do expect the -- to continue to write new business because there's strong demand for this product. So if there was 0 movement in housing prices, we'd expect somewhere slightly above the last year of $16.6 million contribution.

Operator

Your next question is from the line of Ed Henning from CLSA.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Just a couple of questions. First one on your collective provision. If you just strip out the movement from your -- from the Great Southern exposure and you leave out the Rural Finance, which I believe came through in the first half, the half-on-half movement was actually down 8%. Is -- are you saying your book improved by 8% over the half or was there some other moving parts in there that drove that?

Richard Fennell
Executive of Customer Banking

The -- you're right. The movement was a positive movement as in a reduction in the collective provision, excluding Great Southern half-on-half, reflecting improved performance on a number of the drivers that go into that calculation, including the probability default and loss given default. We haven't -- we didn't change any of the overlays -- model overlays or management overlays that were in place other than the -- adding the Great Southern one. It was simply the underlying models producing a lower result given the recent performance.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay. And the second one, just on your favorite topic, capital. You guys said you've got a strong capital position, but obviously monitoring what's going on globally and domestically. Are you guys -- and if you look at kind of your organic capital profile -- and today, you've called out you want to grow. So obviously, that's going to chew up some of your capital going forward. Looking at your organic capital generation, is really the Advanced Accreditation what you guys are pinning your hopes on to kind of help bolster that level? And just touching on that, can you -- you briefly mentioned obviously, you're still striving towards this and it's in with APRA. But can you give us more of a bit of a timetable on how long you expect it to roll through? And what's your expectations on the benefit from capital if you are able to achieve it?

Richard Fennell
Executive of Customer Banking

I might do the first half and I might throw to the boss for the second half of that question, Ed. The one thing that has been a pretty significant drag over the last, probably, couple of years from a capital perspective is the capitalized expenses and intangibles that we've been adding to as we've been investing in the Basel II program, in particular. Now that we've done the heavy lifting on the build there, I'd be expecting that to ease up to some extent. And if that's the case, then looking at the last 12 months, that would certainly improve our organic capital generation and help to create some headroom for a faster growth in risk-weighted assets. Mike, do you want to comment on the...

Michael John Hirst
Former MD, CEO & Director

Yes. So the process continues as we work our way through. Like all the discussions we have with APRA, they're confidential, and we're not in a position to be able to talk about those. It's complicated, of course, by some of the recommendations coming out of the FSI to decouple the way things go about it. Then so this is the first time anyone's had to deal with some of those things, and we're very happy with the engagement that we're getting. I can't say a lot more than that.

Operator

Your next question is from the line of Nicole Mehalski from Merrill Lynch.

Nicole Mehalski
BofA Merrill Lynch, Research Division

I just had a question around expenses. It's been quite a good trend in the half, and I guess I wonder whether you can talk about how sustainable that is and whether there's anything we need to think about in terms of the Basel II costs. I understand, a part of it was sort of expense dropping out of the equation. And then another quick question just on other income. The trading revaluation on investment income was up $6.5 million. I wonder if you can just give us some color on that too.

Richard Fennell
Executive of Customer Banking

Yes, all right, on the expenses, there is half-on-half seasonality, which will play against us in this next half with the days in the half. Also this is the half where we do pay our -- or make our adjustments to salaries and wages, although that's going to be tempered, I think, as it will be right across the economy in this very low inflationary environment. However, whenever we do make those adjustments, there is a one-off impact to accrued leave balances, which hit in our expenses as well. So if you went -- if you go back over a number of years, you probably will see a bit of a -- well, you will see a trend with the first half of the financial year, the December half, generally having a stronger cost growth or expense growth profile than the second half of the financial year. But we will be looking to actively manage the costs as best we can, which is appropriate given the charges we're seeing for a margin and broader revenue perspective. But I wouldn't expect the second half to see a continuation of the trend in reducing our total expenses half-on-half. In relation to the trading book contribution of $6.5 million, we use our trading book primarily for our liquidity management. But the way we set the profile of that, we do use that partially to manage interest rate risk in the banking book. And the 2 cash rate reductions, the trading book has benefited effectively as a natural hedge against those. So that's been the reason we've seen the strong performance there. We do set a -- like the treasury guys do their best to contribute through that, but a lot of that is driven by the interest rate environment and what moves do occur. So that's the reason we've had the strong contribution this half. I wouldn't expect to see that strong a contribution in most halfs going forward unless we saw a similar cash rate movement in the half, and I'm certainly not hoping for that.

Operator

Your next question is from the line of Andrew Lyons from Goldman Sachs.

Andrew Lyons
Goldman Sachs Group Inc., Research Division

Just 2 questions. Firstly, just on the Homesafe portfolio. You do note that the unrealized gains on the Homesafe portfolio aren't recognized from a capital perspective. Can you maybe just give us some -- provide some clarity on just how large, I guess, that has been a drag on capital, I guess, versus earnings in recent years given the appreciation in house prices? And does that only come back to you from a capital perspective when you actually realize the profit on that through an actual sale? And then just a second question just on margins very simply. Just if we assume cash rate to remain flat into 2016, what sort of a drag would that represent on your low-cost deposits and free fund?

Richard Fennell
Executive of Customer Banking

All right. On the Homesafe, FY '15, the retained earnings -- sorry, yes, the addition in retained earnings from an accounting perspective versus a capital perspective is about a $13 million difference -- sorry, 13 basis points different in capital. The -- from a total capital position, it's about 45 basis points. Now we do bring that to account when we realize the property. So if we effectively shop [ph] the book now to any future new properties joining the portfolio, over time we would, as those contracts complete, gradually bring to account that additional 45 basis points of capital. And that calculation obviously, basis points based on our current total capital position and balance sheet. So it's not an insignificant amount of additional capital that, over time, will be brought to account. The second part of the question around the -- if we assume no movement in the cash rates, then with no movement in the cash rate, we wouldn't expect there to be any direct -- any additional drag from the movement -- well, sorry from the contribution of the at-call deposits and well, the low-cost deposits. Although obviously, there's a -- that has been a gradual impact over the last 6 months. So there's still a little bit of that to potentially work its way through this half year until we get a full half year based on the 2% cash rate. Having said that, I will be hopeful we would be able to offset that additional drag through the mix change going from term deposits to at-call. So with no other movements in the cash rate, I would be hopeful that we're not going to see further reduction in our margin -- our closing margin based on the deposit side of the business. What happens on the asset side is a little bit more fluid in the current environment.

Operator

Your next question is from the line of from Louise Weihart from Mergermarket.

Louise Weihart

Could you possibly give some color around what type of acquisition could provide a strategic fit for you guys? And are we likely to see any this year? And then just on Basel IV, is it likely that you may consider raising capital this year? And if so, what form would that take? For example, would it be on market or might it be a DRP, et cetera?

Michael John Hirst
Former MD, CEO & Director

Okay. So on the first thing around the acquisitions, I think Jon called out earlier, New South Wales is a weakness in our distribution network at this stage. So I think if there was anything in New South Wales, that might pique our interest. The -- a large bank model, I think, through opportunities for credit unions is a good one for us, and we're making some investment there around systems, et cetera, to make that easier. So there's another opportunity. And I wouldn't rule out anything that makes sense for us in the wealth space or across other loan portfolios. So the one thing I will say is that we're very rarely -- we're not going to do any of this unless we're invited to do so. So we won't be aggressive around that space. In respect of Basel IV, I don't think there's any need for us to think about raising capital in the absence of any information coming forward that would suggest we need to.

Operator

And your next question is from the line of Richard Wiles from Morgan Stanley.

Richard E. Wiles
Morgan Stanley, Research Division

I've just got a couple of questions on the margin. Firstly, do you expect competition and margin pressure on the owner-occupied loan book will increase market-wide following the moves by other banks to increase their investment property loans? And then secondly, on the investment property loan portfolio itself. It looks like you've got less exposure to variable rate investment property loans. Could you quantify how much of your investment property loans are variable rate? And could you also explain why you're not increasing your rates? It seems an irrational decision given the amount of margin pressure you're experiencing at the moment and given how sensitive your property is to margin outcomes.

Michael John Hirst
Former MD, CEO & Director

All right, so the first part of that question around owner-occupied. I think the most sensible way to think about it is what would the differential be between owner-occupied and investor rather than will one go down and will one go up? And then, we've seen an opening up of that variance through this round of repricing. Some have been more aggressive around that than others. But I think I would expect to see an increased focus on risk for pricing -- or risk pricing going through this piece and that would suggest a widening of loans between investor and owner-occupied, and as we've seen from one institution, a widening between interest-only and P&I-type loans. So all of those things I think are reflective of the different risks associated with those loans. In respect of the fixed versus variable, I'll hand over that in a moment and Richard can answer that hopefully. And in respect of the issue around why we haven't repriced, well, the reason that our growth's been under is because our pricing hasn't been as competitive as it could have been over a period of time because of the uneven playing field. We have said on many occasions that we'll only write business at profitable prices so our prices have been at a point where we can make a profit. The rest of the markets priced up towards where we are. We're comfortable that we can make money at those prices. Now it may be that because of the actions of others that we've seen so far and what may still come, that could throw our balance between investor and owner-occupied out of whack, in which case we'd have to make some adjustments to our current settings. But time will tell in respect of that. As much as we'd like to think we are a price maker in the market, I think that's fairly obvious that's not the case. So we'll continue to manage our margin as effectively as we possibly can. And I think over time, we've proven to have a good track record in doing that.

Richard E. Wiles
Morgan Stanley, Research Division

So Mike, just if I could follow-up there, sounds like you're managing your decisions or making the decisions on the investment property loan portfolio in isolation rather than thinking about managing the entire -- the margin of the entire bank. At the moment, there's 7 basis points of margin pressure in the second half. As Richard has mentioned, you haven't yet had a full year -- full half impact from the lower cash rate. It looks like competition on the owner-occupied side is going to increase, not decrease. And yet, you're not taking the opportunity to reprice the one part of your book that actually could help the margin out. It sounds like you're happy to let the margin go down just to get a little bit of extra volume growth in the IPL space. [indiscernible]

Michael John Hirst
Former MD, CEO & Director

Well, I think, Richard, there's a couple of things around that. Sorry, I didn't hear that last little bit.

Richard E. Wiles
Morgan Stanley, Research Division

The last bit, Mike, was that you'd prefer some volume rather than margin.

Michael John Hirst
Former MD, CEO & Director

All right. I think, Richard, there are couple of things around that. One is I think we've got a pretty proven track record around margin management and you can assume that we'll continue to make sure that we do that. Secondly, I've tried to answer your question as honestly as I can, but there are laws around pricing lien [ph] and other things that prevent me for perhaps telling you what I'm going to do or what the bank's going to do with its rates.

Richard Fennell
Executive of Customer Banking

Richard, on the mix numbers, I must admit, I don't have those numbers to hand, but certainly happy to take that on notice and we'll share that information.

Operator

Your next question is from the line of Andrew Triggs from Deutsche Bank.

Andrew Triggs
Deutsche Bank AG, Research Division

Just a couple of questions. Firstly, in the business space, the trends you're seeing there in terms of what's holding back growth. Is that more a comment around where margin and competition is in that space? And also, the re-rating of the business book for Advanced, is that fully completed now? That sounds like it's been a bit of a headwind on business banker's time? And just to follow-up on margin again. Just your -- some clarity around the hedge book protection on cash rate reductions, the length of the book and whether that has protected you from some of the cash rate reductions seen of late.

Michael John Hirst
Former MD, CEO & Director

Sure, I'll handle the first part and Richard will deal with the second. But the best way to respond is probably to merge the first 2 parts of your question. And the re-rating of the bank book has been a very significant piece of work that was undertaken by all their business banking teams. And I think it's fair to say that the expectation for them to write additional business during the period when they were undertaking all that work would have been unrealistic. And there has been a period of, I guess, pullback on the new business piece while all that work was undertaken. But that is complete now, and I would expect to see a continued growth in that business banking book.

Andrew Triggs
Deutsche Bank AG, Research Division

And on the hedge book?

Richard Fennell
Executive of Customer Banking

Thank you. The -- look, the margin impact if we didn't have the hedging in place would have been significantly greater. The -- we -- hedging, we do position ourselves to offset the vast majority of the risk on downside cash rate movements, but the reality is often we don't hedge that fully because, depending on the margin expectations built into the market, there's actually no value in putting in place those hedges. So if the margin -- if it's -- sorry, if the market is assuming a reduction in interest rates beyond our view, then there's -- we don't see the value in actually putting that in place, those hedges, because the cost of the hedge will be the same effect as if that plays out. So look, although we do our best to hedge those -- our position against the reducing rate environment in a time like the last 6 or 12 months, the reality is we are not always fully hedged. And the other thing that does actually impact the margin is the cost of having those hedges in place. Because obviously, taking that cover at a time when the market is already building in an assumption on the reduction in interest rates, you're effectively locking that margin reduction in.

Operator

Your next question is from the line of Brett Le Mesurier from APP Securities.

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

Just to continue on the line of the margin. What is the difference between the margin on the business that you're currently writing and the margin that you earned during the course of last year?

Richard Fennell
Executive of Customer Banking

Well, I think if you -- I'm trying to find the exact page to reference for you. But Slide 15 of the pack, Brett, shows you the monthly margin and 3-months rolling margin. And as you can see, over the course of the last 12 months, that jumps around. Hence, we get the 3-months rolling one to take out some of the noise in there. But the exit margin is around about the average margin for the last 6 months at 2.17%.

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

Sorry, I meant the loan margin.

Richard Fennell
Executive of Customer Banking

Oh. The -- I don't think we have historically -- well, actually, we haven't historically disclosed the margin on the asset side versus the liability side of the book. And...

Michael John Hirst
Former MD, CEO & Director

I think the changes to the FTP that have been put through would make any comparison silly.

Richard Fennell
Executive of Customer Banking

It is -- Brett...

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

It looks -- well, to help you out, it looks like your margin declined on -- your loan margin decline has been about 50 basis points in the past 2 years. Would that be -- is that a fair comment?

Michael John Hirst
Former MD, CEO & Director

Well, I think we've seen cash rate reductions of about that amount, so that probably would make some sense.

Richard Fennell
Executive of Customer Banking

And I mentioned earlier, Brett, a reasonable element of that has been driven by the change in our FTP methodology. But the level of competition in -- over the last couple of years, 2 or 3 years ago when we were sitting here, most of the time we were talking about the sort of discounts available on standard variable rates being in the order of 70 to 80 basis points. Now we've been seeing well over 100 basis points being offered out in the market. On top of that, we've seen incredible levels of competition at fixed-rate lending, which has had a very significant impact on margin right across the industry. Interestingly, that -- the level of competition there hasn't eased up, but the demand for fixed-rate lending, I think, has eased up a bit as I think people are feeling more comfortable that we're going to be in a low-rate environment for longer and therefore, not feeling the necessity to lock in a fixed-rate mortgage.

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

So it's fair to say that -- and we should be thinking about the loan margin continuing to fall, not offset entirely by declines in deposit margins, with the result that the return on tangible equity is going to continue to fall as it has since at least 2012 as shown in the -- in your Appendix slide?

Michael John Hirst
Former MD, CEO & Director

I think it's a long bow [ph] to suggest the margin is going to continue to fall on loans. We've just seen a whole market reprice in the other direction. And we've had a fairly long discussion about how that might pan out. So I wouldn't be building that in.

Operator

Your next question is from the line of T.S. Lim from Bell Potter Securities.

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

Just wanted to get some color on some state performance like WA or Southeast Queensland. What are you seeing over there right now?

Michael John Hirst
Former MD, CEO & Director

From a credit point of view, T.S.?

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

Yes, it is. Yes.

Michael John Hirst
Former MD, CEO & Director

Now we're seeing reasonably consistent outcomes across most of the states. And I think our business in Western Australia is predominantly consumer- and agri-based, and we're not seeing any real pressure there, similarly, in Queensland. So even though those states are obviously impacted by mining and the outcomes that are currently being experienced there, we haven't seen that feed through into our books in any discernible way yet.

Operator

There are no further questions at this time. Please continue.

Michael John Hirst
Former MD, CEO & Director

Well, if there's no further questions, I think we'll wind it up there. As I said at the start, we know this is a particularly busy time for many of you with all the announcements and other things that are going on around banks at the moment, so greatly appreciate you making the time to be with us today. Thank you.

Operator
And ladies and gentlemen, that does conclude today's conference. Thank you for your participation.