Question and Answer

Operator

[Operator Instructions] The first question today comes from Richard Wiles from Morgan Stanley.

Richard E. Wiles
Morgan Stanley, Research Division

A couple of questions, please. First one relates to the provisioning. You've gone from having an overlay, which was lower than your peer group at the first half to one that is now at the top end. Do you think you are just taking a conservative approach? Or have you previously underestimated the risk? And could you comment specifically on what credit quality trends you're seeing in the commercial real estate portfolio?

Gary Andrew Lennon
Chief Financial Officer

Ross, want me to take that?

Ross Maxwell McEwan
Group CEO, MD & Director

I think it's a good one for the CFO.

Gary Andrew Lennon
Chief Financial Officer

Great. Thanks, Richard. So a couple of comments there. In terms of what we're seeing in the underlying portfolio, I think similar to our experience across much of the sector, is not a lot as yet. And that's really because of what Ross and I both mentioned of the degree of support that's in the system, where we think it's going to be. And I think we all believe it's going to be an interesting period as that support starts to get taken away, and there's the transition to stimulus. So we haven't really seen any deterioration across the broader portfolio, including commercial real estate to date. So it's been pretty stable.

In terms of the increase in provisioning -- and I think we said right at the start of this that we're all going to learn as we go through this and trends are going to become more obvious. And certainly, some of our economic assumptions at the half, in hindsight, have proven to be a bit more optimistic about the in, outs of the recovery and the speed of the recovery. We now look at it, and it's a lot more obvious that this recovery is going to take longer than what we originally thought. It's becoming clearer, and this is particularly influencing our thinking around aviation that international borders by all likelihood are going to be closed longer. Certainly, the internal borders in Australia to be closed as long as they have been, that was unexpected to date. So there's some difference in trends.

But probably the biggest difference, which we're really seeing, Ross has sort of touched on it a bit, is what we're describing is the uneven nature of this downturn and how we really do have some of our customer base, in fact, are doing particularly well and thriving in this environment as it plays to that customer base. And you can -- Ross sort of cited, if you're a suburban café, then you're probably doing a lot better than you are in the CBD. We see the agri sectors doing really well and flying.

So -- but increasingly, there's the other side of that, where sectors are really struggling. And as you get more granular, it's not even clear cut by sector, by geography. Even within sectors and within geographies, you get customers that are doing well and not so well. And that has really influenced as we've dug into this provisioning question and thought about provisioning because, as you will know, Richard, you don't lose money on what's happening on the average of the portfolio. You lose money of what's happening to the tails of the portfolio. And with this unevenness, we have a dispersion where there's probably going to be more in the tails, and it does get somewhat masked when you look at averages. And that's helped, informed the fact when we ran our models, et cetera, that we needed to top-up our EA and we needed to top-up our FLA.

And we probably had a little sprinkle of conservatism with that as well, but that helps. So we're feeling very pleased about strong capital, strong liquidity, strong provisioning. I hope that helps, Richard.

Richard E. Wiles
Morgan Stanley, Research Division

And could I ask a second question, please, on your target for double-digit cash ROE? Ross, you mentioned at the outset that you expect interest rates to stay low in the medium term. So I assume your ROE target doesn't rely on any increase in interest rates. Could you comment more specifically on whether you think you can stop the margin decline beyond FY '21 when you're clearly expecting it to fall and whether your assumption for a double-digit ROE assumes that your Common Equity Tier 1 ratio gets back down to 10.5%?

Ross Maxwell McEwan
Group CEO, MD & Director

I'll start at the back end of that. I mean we do have a higher CET1 ratio for very obvious reasons. I said right at the start, I wanted this bank to be safe and secure and nobody to worry about it. And we would run with higher knowing that we would have impacts on it over the period of time. So I think you're right making the assumption over the next few years that will come back to a more normalized level. So that is one factor.

The second thing is we are going to have a very, very competitive market with low interest rates. That's not going to go away. We just need to be much, much better in this marketplace and how we operate. Our costs, as we've discussed, need to come down. I don't see that happening this year, and that's why we've given you the 0% to 2% this year. But they have to start coming down over the 3 to 5, and we've given you the bench of the $7.7 billion for the exit out of 2020. We need to use technology and much better efficiencies in this business to get our cost down, and we're working on that right now.

I think the work that's been done over the last 3 years has been very helpful there. Some of the foundations have been put in place, which are very helpful for this bank. And we're starting to see some of the fruits of that as well. But we've got a big investment portfolio of spend this year, $1.3 billion. But we're going to be targeting growth in the core parts of our market.

And so we want to see growth. And I want to see costs come down over the 3 to 5 years. Capital, yes, we're running elevated levels right now. And we'll maintain those while there is uncertainty in this marketplace.

Operator

The next question comes from Victor German from Macquarie.

Victor German
Macquarie Research

I was hoping to ask 2 questions as well, 1 on revenue, 1 on costs. I might start with the revenue one. With respect to mortgage growth, it appears that you've struggled lately to grow that part of the business. I've noticed that your economist is looking for a fairly subdued outcome next year in terms of volume growth. If that actually sort of surprises on the upside relative to that expectation, do you think that you can regain market share and grow broadly in line with market? And do you think you need to sacrifice more margin in order to do that?

Ross Maxwell McEwan
Group CEO, MD & Director

Well, first off, on mortgage growth, I take our loss of market share early on, on my [hands] over the last 6 months. As we went through the COVID, I said to the team these are times when we should be very cautious. We dropped out the -- what was a 3,000 or 4,000 cash back that was going on in the marketplace, and that damaged our market share growth in 2020. So I take that onboard personally myself.

Let me be quite clear. We're already starting to grow again. We will be competitive. We've got a machine now that is starting to come together quite nicely. We don't have the difficulties we had some time ago in the back end of our business. We've now seen that the broker community has us rated up as 1 of the top 2 players of the big banks for service delivery, and that's what we're going to play on. We'll be a much more difficult competitor in this marketplace going forward.

So yes, we'll let -- create growth. I believe it will. You've seen us with competitive rates out yesterday, showing that we're a player in this marketplace, and we want to grow. This is one of the core markets for us. And we're now building 1 mortgage engine, not 4 or 5 other things. So yes, I think that'll give you a clear signal.

What will happen to margins? Well, it's a competitive market. And margins, we hope to hold on to. I think we were one of the most disciplined banks on margin in the last year as you've seen as the other results have come out.

Victor German
Macquarie Research

No, that makes a lot of sense. And just on costs, I'd be interested in your observation and also Gary's in terms of the appropriate investment spend. We've seen a couple of your competitors or peers talk about much higher investment spend in the short term. Are you comfortable with $1.3 billion? What do you think is an appropriate number?

And maybe, Gary, if you can also give us a sense for amortization expense. I've noticed that your amortization period is still 5 years. It appears that it's much higher than what peers are doing. And the charges coming through the P&L is lower, in your 0% to 2% cost guidance. Are you anticipating that, that number will increase?

Ross Maxwell McEwan
Group CEO, MD & Director

Yes. Thanks. I'll start on the $1.3 billion. I think the $1.3 billion for this year is fine. It's more around what you do with the money rather than how much you've got. I mean we were spending a lot more on this in the last 3 years. I think we can do just as well by delivering better and being far more focused on a smaller number of programs. We talked about that at the half year. I started -- I think we had 467 programs of work going on in this place. I've got 19 that I care about, 19 my executive care about. We've funded them, and we'll look to get delivery against those. And I think that'll give us a better result.

So I'm less worried about the amount. And I think $1.3 billion is plenty. Once you get over that level, it's pretty hard to know how you spend it. And you get all sorts of strange things going on in the business. So I'm very comfortable with $1.3 billion. I believe we can do it, what we need within that and again, get ourselves into a good competitive position with costs coming down over the longer term -- medium to longer term.

Gary Andrew Lennon
Chief Financial Officer

Victor, I'll add to that a couple of things. So as you know, we started in '17, uplifting our investment spend. So we've had quite an elevated investment spend for a number of years. And some of the competitors saying they're elevating their investment spend now might be just a timing issue, but we kicked that off a bit earlier. That's certainly how we view it and how we feel about it and a lot of the core infrastructure technology fundamentals that we now have in place, which others may still be required to build.

On the useful life metric, which is just a calculation but it's -- a couple of things to point out there, Victor, is, firstly, it is a bit distorted, this period, because of the policy change. So a lot of the -- we did that policy change at the half year where we would just expense the low-value projects. So this is $5 million and under, would go straight to expense. And it's often that those lower value projects had a shorter life, so nearly by default. So it's not essentially a lengthening of the average life. It's really that policy change that's driving the lengthening.

But there's still an element of merit in your question and the direction. And so there will be an uptick, and we do expect -- continuing to expect for a while, probably next year and maybe the year after, a bit of an uptick in amortization costs. And just to give you a sense, it would be around about $70 million for '21, is that uplift in amortization costs over this year's baseline.

Operator

The next question comes from Jarrod Martin from Crédit Suisse.

Jarrod Martin
Crédit Suisse AG, Research Division

A couple of questions. So first of all, just a follow-up on the cost one. So if you take the midpoint of your guidance for next year of about 1%, that there doesn't look like a significant hurdle in terms of getting to your medium-term aspiration of lower than the $7.7 billion. So inferring into that, is there a bit of an expense build for a couple of years before we start to track towards that $7.7 billion? Is that the way to look at it? And then I have a follow-up on mortgages.

Ross Maxwell McEwan
Group CEO, MD & Director

I think that'll be fair. But that expense build was in 2020 and 2021. After that, we'd -- I'd expect to see it coming down. We did have additional expenses in the second half of this year as we headed into COVID. We also, remember, restructured the bank right through the middle of this year into the latter part of this year. So there are some restructuring charges that we've just put through the business. We didn't put them under the line like other players. We gave them to you as a cost. It's a cost of doing business, and it will be a continued cost of doing business. So you put them into the business. So there was some there. And we've taken some costs this year related to COVID of getting pretty much all of our colleagues working from home and the cost of supporting customers through this.

We also have some elevated costs going into 2021 with additional people going into NAB Assist, which is our vehicle for helping customers who are having a bit of difficulty and also into SBS. And we're building more capability in greater numbers in our business bank and in our private bank. We've committed 55 -- 550 new heads into that area for this year. So there are costs. They will obviously have to come out of other parts of the business together the -- at a 0 growth longer term. But I'm happy to spend money on the business where I see growth, and you're starting to see that coming through now in the areas we like.

So yes, you're seeing 2021 for slightly different reasons to '20 -- sorry, '20 increases more to do with COVID and restructuring. '21 has more to do with putting bankers back into places where we probably should never have taken them out of and starting to grow our private bank again. We used to be the best private bank in Australia. We are going to be the best private bank in Australia in the next few years. So we've got the right tools. We just need to put them in the right place and get on with the job and be good for customers that cost you money.

Gary Andrew Lennon
Chief Financial Officer

And Ross, I'll add to that. And Jarrod, just what we're essentially viewing this, you've got to take a disciplined but balanced approach to how we're dealing with costs. At one level, if cost out was the only objective, it would be relatively straightforward. But if you're wanting to grow the business, if you want to respond to how our customers are responding to us and wanting more self-service, more digitization, you have to continue to invest and play into that. And there was a major change and trend change along those lines. So we want to make sure we're getting that balance right of investing the right amount, continuing to invest whilst also driving the productivity. So that would hopefully lend to that sort of modest shape for modest cost increases for a couple of years and then the ability to bring it back once we're sort of through that.

Other -- other points of interest there is we do expect the reg and compliance spend to continue to be higher for '21. Hopefully, that starts to moderate down over '22 and beyond, and that will help change the mix of where we're [expanding] more towards productivity and business growth. And finally, it's really where Victor was at before. There will be some headwinds associated with the investments we've done in the past and amortization coming through. So trying to get that valid balance right across that whole package and we think it is the right 3- to 5-year target to get to lower absolute costs in a pretty tough environment. And we think we've got a balanced and sensible pathway to get there.

Ross Maxwell McEwan
Group CEO, MD & Director

Gary, the other area that probably hasn't been recognized that strongly but is quite an expense for any bank is on the area of fighting against fraud, cyber and obviously, KYC. But we're seeing, and we've been quite clear about this throughout the year and in our results today, the attacks on banks or any organization that has customer data, payment data is very accelerated. So we're having to spend money on those areas to keep our customers and the bank safe. I don't see that going away.

But every bank is going to be experiencing that. And that's why you're probably starting to see some difficulties. Everyone says you want to get cost out, but it's how you get the cost and where you take it from. Otherwise, you end up with explosions in areas of fraud on behalf of the banking customers and cyber. So a number of areas, and it is a balance of we're giving very clear signals that, in the 3 to 5 years, we'll be back to a cost base of $7.7 billion or less.

Jarrod Martin
Crédit Suisse AG, Research Division

And a second question on mortgages and be interested in your perspective on this, Ross, given your U.K. experience. We now have fixed rate mortgages that are substantially below and pricing below variable rate mortgages, 100 basis points plus and expectation of low rates for longer. Are we likely to see a permanent shift in the mortgage mix of the Australian market to move to predominantly fixed rate mortgages? And what that means for the competition? Because you no doubt would have seen in the U.K. how competitive mortgages and fixed rate mortgages have sub-1.5% rates in the U.K. and margins are crunched and also what it means from a, I suppose, a financial system perspective that the transmission mechanism for the RBA rate cuts is obviously a lot less effective under a fixed rate mortgage regime.

Ross Maxwell McEwan
Group CEO, MD & Director

Yes. No, look, some good observations here on the transition mechanism because you -- transmission mechanism because once you get rates at sub 2% and they are fixed for 4 years, any changes there don't have any impact at all. But the reality is that this market is moving to more towards fixed rates for certainty, was about 10% of the book. I think you'll see quite quickly it getting to 30% of the book. We're seeing that on the flows today.

But I'd like to debunk something just around the variable rate. I mean you can get a standard variable rate for 2.69 from us. And if you've got it from another bank at a higher rate, then that bring it across, but you can get a standard variable at 2.69. But you're right. The fixed rates at 1.98 for 4 years is becoming a pretty big proposition for customers. And we are seeing that trend going across. It's going to be a competitive marketplace. And that's why we've decided to go for one mortgage engine and one factory and take the costs out, and we have to streamline things. You've got to use digitization a lot more, and that's what we're doing. We're investing heavily both on this side of the business, but don't forget, we're also heavily investing in our business bank processing capability as well. And that's where we're going to spend a lot of money over the next couple of years because margins will come out of this business, and we want to hold the profitability.

But it's -- we understand the market. We understand that you've got to be competitive. We want to be strong in this market and then clearly signaling we're going to be. I sort of know how this market works, both from the U.K. and from Australia. So -- and as I said, we backed out for about 3 to 6, months thinking the market might have been a bit more sensible. It wasn't. We're back in getting market share again, and we'll make sure it's profitable.

Operator

The next question comes from Andrew Triggs from JPMorgan.

Andrew Triggs
JPMorgan Chase & Co, Research Division

My question on the business bank. For most of the last a few years, the business bank has delivered relatively stable NIM. Obviously, this period saw the impact of rate -- the RBA rate cuts. But following this sort of final rate cut if it proves to be that, would you expect to see reemergence of resilient NIMs in that division? What are you seeing in terms of growth from asset write-off rule changes as well within the business bank?

And finally, on the deposit base, obviously, more of your deposit base sits with business banking customers than retail customers at least compared to your peers. Is the distribution of that interest rate -- well, the interest rate distribution on that book similar to the retail book? Are you equally comfortable at taking out deposit spread savings in the business deposit book as you are in the retail deposit book?

Ross Maxwell McEwan
Group CEO, MD & Director

Probably yes to the last one. We've got quite stable deposits in the business bank. It's been stable for a long, long period of time. I don't really see that as changing. And we've had quite reasonably stable NIM in the business book itself.

There's pressure there. There's good competition in that marketplace. What we've found is that we just need to be much better at the processing end and freeing our bankers up. And, thus, the investment in that market to actually get our bankers with more time out in the marketplace has been the issue for this bank and why I think it hasn't grown as it should have.

We've also been, in the last 6 to 12 months, very consumed with looking after existing customers and not hunting the market for new growth because our customers, a number of them, have been in pain and would have to have the focus of our bankers on looking after customers who have gone to deferral, get them in the right position.

But it's a pretty stable NIM story. From that, I'll get Gary to speak on and see if there's anything different and same with the deposit book. But it's a good competitive marketplace here in Australia. And again, this is homeland for us. We've got great expertise here, and we're going to build it.

Gary Andrew Lennon
Chief Financial Officer

Yes. Ross, probably the 2 other things to add and, Andrew, you were going to an interesting place or an appropriate place. So in particular, business and private are impacted by the low rate environment. So that comes through hitting deposit floors but also how we allocate with our capital returns. So it comes through that deposit and what we call capital benefit, which has impacted the overall margin rather than the customer margin. So it's been more of that low rate impact rather than the margins we're actually seeing at the customer level and your observation around the deposit base.

Look, given the changes where rates are going, I think there's more work to do in repricing those deposits down. I know the team is focused on that. It can be painful for those customers and the rates that you get. But in the low rate environment, that's it. We also get some offset just through that, that shifts away from term deposits into -- there's a lot more on demand deposits, which we are getting benefit from and actually working hard to ensure as much of that as possible is sticky money rather than money that has come in and flies out. So we do see that as an opportunity to really work hard with that money that's come in and sitting in transactional accounts that how do we make that situation more permanent at those type of levels. And that's something that Andrew is focused on in future periods.

Andrew Triggs
JPMorgan Chase & Co, Research Division

And Gary, the question around volume growth, it looked like business lending volumes were fairly stable, which is probably a good outcome given what the system is doing. But what you're seeing on the ground there, I know that your economist forecast is sort of the reverse of what Westpac's are with respect to housing versus business system growth. What makes you confident you can see growth in the system for business lending?

Gary Andrew Lennon
Chief Financial Officer

Yes. We all know you get 10 economists in the room that will come up with different views on the same -- they'll all say they're not wrong. Their models are right because their assumptions are wrong. The -- in terms of the business lending, yes, look, it's turned out to be a difficult environment for SME lending. And we thought it was a bit of a disappointing result, albeit it was slightly up. But then when we're seeing our peers' results, it's not looking as bad on a peer relative basis.

But as Ross has said, we're looking to grow in that space and see opportunities. And we are -- it's early days, but the start into 2021 has been pretty solid. So there are some green shoots there, and we'll continue to press hard.

As we already mentioned, agri and rural is looking strong in more recent years, which we think has been the right decision. We've really pulled back from CRE, so we've been pretty sensible on that. So that's subdued some of the headlines. But we do see plenty of opportunities to grow and we're going to be quite competitive and aggressive in pushing that growth. And Ross has already announced with Andrew, we're going to be putting more 500-plus sort of bankers into that platform to really get momentum back into that important core part of our business.

Ross Maxwell McEwan
Group CEO, MD & Director

We are seeing -- it's very early on, but we are seeing more confidence coming back in. Just the sheer fact that Victoria has opened up 1 week has put some life back into the Melbourne and Victorian market, a long way to recover from where we've gone down to. But we're out there. We've been concentrating, as I said, very importantly on existing customers. And we've taken our focus away from growth. Now we're back on the job of both. And we like this market. This is ours. This is homeland for NAB. Thank you.

Operator

The next question comes from Brendan Sproules from Citi.

Brendan Sproules
Citigroup Inc., Research Division

Ross, I just got a question on UBank. You outlined today that you want to spend some more money in that particular franchise as a digital attack. I was wondering if you could outline what sort of differentiated proposition that you imagine UBank can provide.

And then just a second question on the fixed rate mortgage. It's pretty much following on from what Jarrod was asking. I mean if we do get to a situation where 30% of the mortgage market is fixed rate, as you mentioned, what happens when the TFF is removed? I would suggest to you that U.K. and Australia is quite different in that sense in that we're quite shorter deposits relative to the U.K. Just how you imagine that playing out, please?

Ross Maxwell McEwan
Group CEO, MD & Director

I'll start with the back in there. The U.K., remember, had a very similar scheme on the TFF. They had a funding for lending scheme up there. That was [up] the cash flow to 25 basis points. That actually ended the -- Australia's found itself in a very similar position to the U.K. on that same basis. And remember, the U.K. was a or still is a very fixed rate market as opposed to a variable. And banks still make good money out of that as long as you had a very good process and again, good distribution.

So I think at 30%, could be more than 30% it ends up at. We would have suspected more than 30%. But I wouldn't fear that because there are some things that are going in favor of the bank at that point in time, particularly if it's on for 2, 3 or 4 year, 5 years. You're not having to deal with the administration of it every year. But there's [a ton of] margin. You've got to be better at playing in that market.

On UBank, we do see an opportunity for Ubank, and we started this as part of our review. We think there's -- it's held on to quite a nice niche of customer service delivery on -- and how customers think about it over the last 12 years. We haven't really invested that well into it over the last probably 5 years. And our view is we invest a bit of money in here. There is a group of customers that would be attracted to UBank brand, and it's mainly in the more youth market.

I notice other players doing other things to try and get into that market, all sitting under our noses. We have a brand that has 600,000 clients that we can talk towards that, we think, it's worth the investment on behalf of shareholders. So we'll be more towards the youth market.

But also, you've got to be ready to use the advantages of open banking, and that's something we'll concentrate on both in the big Red Star and in UBank to get ourselves ready for using that data to actually put better propositions for customers. So we've been working on UBank at the moment, getting its plans, prepared to invest in it. But it'll go after a different group. Probably the Red Star we'll go after, definitely good for customers.

Operator

The next question comes from Andrew Lyons from Goldman Sachs.

Andrew Lyons
Goldman Sachs Group, Inc., Research Division

Just 2 questions, 1 on margins and then a follow-up on asset quality. Just on margins, firstly, you've spoken to a 6 basis point impact from lower rates in FY '21 and then also spoken about further competitive pressures offset by modest funding cost improvements. Bringing this all together, do you think competitive pressures can be fully offset by the improvement in funding costs and so NIM decline next year can be contained at 6 bps? Or is the 6 bps sort of rate impact the best case outcome for the NIM? And maybe if you could then discuss any other offsets that might exist.

And then secondly, just on asset quality, a follow-up to Richard's question on provisions, and I can certainly understanding -- understand you're being conservative here. But can you explain the consistency between the significant top-up we've seen this half in your EA and FLAs against your unchanged assessment of your low-end procyclical capital expectation and a fairly sizable reduction in the high-end procyclical capital expectation?

Ross Maxwell McEwan
Group CEO, MD & Director

[indiscernible]

Gary Andrew Lennon
Chief Financial Officer

Andrew, yes. Yes. Will be mine, is it?

Ross Maxwell McEwan
Group CEO, MD & Director

Feel free to...

Gary Andrew Lennon

Chief Financial Officer

Sure, I wouldn't talk to -- so the first one on the 6 basis points guidance that we've given. Well, yes, there's going to be a lot of variables there, and it's sort of going to be where it's going to be. And clearly, if it continues, where there is a continued trend out of more expensive term deposits to our core deposits, that's going to help our funding costs. The announcement from the RBA during the reg around the TFF will continue to help. So we'll -- I expect that bill as always and cash will continue -- cash costs will continue to be low. So they're pretty decent benefits but probably not a huge amount of upside from what we're already seeing flowing through.

And then at the flip side about competitive pressures, I think it will be intense. You've heard from Ross, there's areas where we're all going to compete. You saw it yesterday with the announcement in terms of competing pretty fiercely on the fixed costs. My expectation is that all the banks will be looking to grow in mortgages. You've got new players in there as well. So I think the combination of all that, and we will maintain as best as possible our discipline around this, which I think we've demonstrated we have done. We will continue to improve our processes and our service proposition. So it's not just about price. So we'll focus on all the things we should focus on. But I do think the reality is that, that competitive pressure is going to be tough. And I doubt whether the funding costs will outweigh it. But that's the sort of time-will-tell question.

Ross Maxwell McEwan
Group CEO, MD & Director

On the asset quality question, Gary?

Gary Andrew Lennon
Chief Financial Officer

On the asset quality, I'm trying to -- given the comparison between what we've done on collective provisions and the overlays and how you compare that, the risk-weighted assets, well, probably the biggest difference here is, on risk-weighted assets, you do get benefits from the upgrades. So when you -- so what the uneven environment we're seeing, you're seeing the dispersion. On credit provisioning, when you see that dispersion and there's more credits that are drifting towards the tail, then that drives increased provisioning. When you have a risk-weighted asset position where there's dispersions, you do get downgrades, but it does somewhat get impacted by upgrades. So it is a different dynamic. And you have -- you do get offsets in risk-weighted assets that you don't get necessarily on credit provisions, particularly once you get the credit losses. So that's part of how you actually reconcile between the 2 of those.

And on the credit provisioning, the downside scenario is probably a bit more severe than the downside scenario that we've got on risk-weighted assets as well. So they're slightly different in terms of the scenarios.

Operator

The next question comes from Jonathan Mott from UBS.

Jonathan Mott
UBS Investment Bank, Research Division

Got a question on Slide 38, which is the corporate and institutional bank. If you look there in the top right corner, you can see that the NIM, ex market, started to rise pretty well from 159 bps to 172. Now this is different to every other institutional bank that I've seen anywhere in the world that you're getting NIM expansion in this environment. So can you explain, firstly, why you're getting NIM expansion, which is obviously besting the group NIM and why this isn't unsustainable?

And a second question, if I could, just relates more to within the mortgage businesses. If you look at where you're actually losing market share, in business and private bank, you saw your housing book fall by 4.6% year-on-year. And in the personal bank, the investors saw 4.4%. Now this goes to Ross, what you're talking about, being your core customers that you want to keep. It actually looks, if anything, that systems close to 0 in this space, you're losing a lot of share. It's not people refinancing for $4,000 in your core private bank, I would have thought. I think this is clearly that you're just not taking enough risk. Do you think that is the case, that you've gone too far to derisk and you actually do need to take a bit more risk in this space?

Ross Maxwell McEwan
Group CEO, MD & Director

I'll start with the final one and then Gary can address the first one because I think he's been good, disciplined in that C&I area that he can speak to. I think it's a whole combination of things in our business and private bank. Part of that is around risk. I think part of that was around the model we were running, made it more difficult for our bankers. Part of that was a lack of focus on that particular part of the marketplace. So I think there was -- it wasn't one factor. There was a number of factors that we're working our way through.

We changed the business model that we were operating with, and we've reversed that out right now. So there's a number of things that I think we just made it too difficult both for our bankers and our customers, and we're changing that pretty much now. I don't think it was around pricing. I think it was just around the model we were running in our business in private banking. And Andrew and his senior team are certainly changing that. And we're investing quite a bit of money on the process that they operate with.

And again, remembering, we ran 4 or 5 different ways of getting a mortgage into this business. We're running with now one mortgage factory that will have one way of doing it, which will make it simpler for our bankers as well with all the efforts going in. So...

Jonathan Mott
UBS Investment Bank, Research Division

This will be one bank. So it'll be one core system across both the private bank and the retail bank?

Ross Maxwell McEwan
Group CEO, MD & Director

And the business bank for mortgages. Yes, we're running one factory, one factory. And in the past, we ran 4 or 5 of these things. So one, cost up; two, complexity up; three, confusion up; and four different model all over the place. So good discipline is going to give us good results in this part of the market. So that's where I think our difficulty became with particularly mortgages in the business bank.

And remembering, too, we've taken what I think was the best private bank in Australia. And you can hardly find it when I arrived. So we're now lead generating that. We've already put on something like 35 to 40 private bankers, and we'll look to grow that because that's where you do some very good business with your business customers at the top end. So again, 2 core parts, I think, we'd let ourselves down. We'll be more -- we'll be better at that going forward.

Jonathan Mott
UBS Investment Bank, Research Division

And the question on the NIM in the institutional book.

Gary Andrew Lennon
Chief Financial Officer

Yes. So Jon, thanks for that. A few things going on here and quite a significant differentiator from other CIB businesses as well. But the first one, David and his team were especially disciplined around pricing, particularly at that higher point of anxiety crisis period. So there was a lot of repricing going across the book in first half, and that's flowed through into the second half of the year and provided some benefit. Now in terms of pricing, I think, stabilize or might be somewhat tougher to retain all of those reprices going forward, but we'd hope to retain certainly a chunk of it.

The second important factor, probably the more important factor, within our CIB business, we have a custody business. And that has -- a significant part of that business is high-quality deposits, and there have been a significant inflow of high-quality deposits into that business. And they earn sort of decent returns or have been earning decent returns. As the cash rate comes down, those returns will start to moderate over time. But for the second half, off the back of that trend, just more of the custodies businesses customers are migrating to cash. That was benefiting the margin in CIB.

Ross Maxwell McEwan
Group CEO, MD & Director

I think there's good discipline within the business of looking at longer term with customers where you get the returns and what returns you get rather than just seeing the dollars come in the door. And I think that in the corporate and institutional bank, you have to be incredibly disciplined. Otherwise, you can put a lot of capital at risk for minimum returns. So I think David and the team have been very disciplined, particularly as some of the corporate customers have been re-rated both up and down. If you don't move the pricing over time when they're rated down, your returns go down to the floor. And I think there's been a lack of discipline in many banks around the world in this very market, and I'm pleased that David and the team are being very disciplined about it, very clear focus. And that's part of the strategy.

Gary Andrew Lennon
Chief Financial Officer

Probably the final point on that is that there has been a bit of distribution that's done some low-returning assets. That helps at the margin -- on the margin. So that business will continue to do it. So I think, Jon, net-net, I think that's been a high point for the margin, but I expect it would sort of come off a bit from there but still be a bit elevated from where it was.

Operator

The next question comes from Matthew Wilson from E&P.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

Two questions if I may. Firstly, to you, Ross. You've actually ran a bank in this extreme central banking policy environment. So you've got credibility in this space. Can you talk about the efficacy of the policy, what you learned from running a bank in that environment and the keys to success in that environment?

And then secondly, your economist's forecast on housing growth look a tad ridiculous given where the RBA, the government policy, given stimulus rates, the level of new lending commitments. What's your economist saying that perhaps the government and the RBA isn't saying because that's the lever that they're aggressively pulling?

Ross Maxwell McEwan
Group CEO, MD & Director

Yes. Well, identified against the economist, he's probably going to be right, but we'll wait and see. He could be wrong as well, but I'll leave you that one with Gary. But one of the big lessons I lived up in the U.K. was capital returns are vital. And you can keep throwing capital at things and not get a return. You've actually got to get a return out of the capital you've put into the marketplace. And it becomes more difficult in a low interest rate environment. Costs become vital.

We haven't seen for 30 years a difficult time in Australia. So we're quietly seeing one now with low interest rate environment. It's going to stay around for a long period of time. It makes running a bank more difficult. And so you have to concentrate on costs, efficiency, straight-through processing, make it easier for customers, let them do it themselves, but also you've got to look at the capital. And that's why that comment around the corporate institutional bank and the measures that David and the team have put in place and looked at pretty much every customer over the long term. Do we make any money? And if not, have the conversations.

And I think in a lot of cases, people get sucked into having the big brands as their customers. You make no money. So I think there's a big disciplined piece in running a bank in this environment. And we've now got it in our corporate institutional, and we'll drop that through into our top end of our business banking operations as well and right across every part of the bank.

And I think that's something 30 years of having a good time in Australia with growth, all of a sudden, it's not here. You've got to manage it quite differently. And you got to be disciplined about where you find the growth as well. So that's the lesson. I did 7.5 years of this grinding up in the U.K., and it doesn't go away. And I don't think this is going away either. So we have to get used to it.

Gary Andrew Lennon
Chief Financial Officer

Matt, it's Gary here. I'll weigh in behind Alan is -- well, let's say, it's been a contentious topic internally, Alan's forecast. And we pride ourselves that Alan's independent. He can form his own views. And the 2 things, Matt, that Alan is looking at and is concerned of is unemployment, which you'd expect and the impact of unemployment; and secondly, the impact of borders shut on immigration. So they're the macro factors he's concerned about concerning that forecast.

Now I'm not saying it's -- well, I think we all hope that, that would be a little bit underdone. I'd like to see a bit more mortgage momentum than that. It's possible that Alan's right. It's possible that Alan's not. So we're not totally dug in behind that in terms of all the decisions that we make.

Matthew Wilson
Evans & Partners Pty. Ltd., Research Division

Okay. And can I just squeeze in one on liquidity? There's obviously clearly huge amounts in the system. You can see that with the LCR. You can see it with the NSFR and your deposit growth where broad money is going, et cetera. Do we really need this TFF? Or is there some other agenda here given the removal of the CLF and the fact that you're going to have to hone more government bonds going forward given the level of government debt in this country?

Gary Andrew Lennon
Chief Financial Officer

Yes. I don't know if the reserve bank has been explicit with that, but I would agree with you. That's the plan, is that there's a lot of incentivizing for banks to be topping up their physical liquids, which means us going in and buying government bonds, which is sort of handy because the government will be issuing lots of government bonds. So you've assumed from that, there will be a good solid underpinning of demand for government bonds and one little of argument that's quite a smart strategy.

In terms of the TFF, look, I think it will be a really helpful tool amongst others. And we've focused on it, as we have senior maturities, then we will replace that with TFF. And so you do get a funding benefit. One of the biggest dilemmas are how we manage our funding book going forward because the -- it's great to get the TFF. They do -- does create a concentration on maturity dates in 3 years' time that you have to manage. And that is not a big problem if you believe all of the inflow and deposits are going to stay. So you do have to make some sort of assessments about the inflow into cash accounts, at-call accounts, how much of that is really going to be sticky money over the medium term and how much of that money is going to -- if things pick up, just sitting there and ready to be deployed to other areas.

And that will help determine then what other steps that you need to make in terms of other issuance to cover the maturity dates of the TFF. So it's quite a complex equation, Matt, to manage our way through this over the next 3 years. And it's exactly the situation they found in the U.K. with the same scheme, where there was a lot of difficult management required around the cliffs that were created by the maturity dates of the TFF equivalent in the U.K.

Ross Maxwell McEwan
Group CEO, MD & Director

Particularly for those that took big tranches of it in comparison to the size of the book. And that's the things you've got to look after, and that's why our treasury function are already thinking about 3 to 4 years out [having refinanced that].

Operator

The next question comes from Ed Henning from CLSA.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Look, earlier, you've touched on before the investment spending, and it's been coming down from $1.6 billion to $1.35 billion to $1.3 billion. Can this fall further to help get your absolute cost target? Or is $1.3 billion a stable level you see investment spend going forward?

Ross Maxwell McEwan
Group CEO, MD & Director

Look, I'll pick that one up. Yes. Look, it was elevated for 3 years as we went through the transformation program that Andrew was running. A lot of that went into our technology areas and to KYC, AML and a lot of areas that I think have been fundamental to the position, a good position we've been in over the last 6 months of getting through COVID and having our technology working incredibly well from off-site.

But our view at the moment is $1.3 billion is the right spend for this year. And here, there's quite a bit still of spend on nondiscretionary spend relating to controls in the business and relating to regulatory spend and the likes. We do see that coming off over a period of time. Not in the next year or 2, but we'd certainly like to see that come off and more spend on discretionary, i.e., growth of the business spend.

So I think $1.3 billion is -- look, we're comfortable with the spend. Of course, if you ask my executives, they'd like to spend twice that amount of money if I gave it to them. But the reality is you've got to get a return out of it. And also the discipline of actually delivering against it and I think we've got a very good balance here now in the business. We've got 19 major programs of work that we're working through and funding -- and funding for the longer term as well. So I'm pretty comfortable with it. Could it come down? Yes, but we do want to see a lot of the work completed over the next probably year or 2 years. I think that's a [indiscernible] is if over the next couple of years, that reg and compliance impost started to come down, then that could be a catalyst bringing it down a bit.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

Okay. That's great. And just a second one. If we move beyond the APRA restrictions on dividends and the COVID impacts, where do you see the medium-term payout ratio supporting your growth ambitions and your 10% ROE target?

Ross Maxwell McEwan
Group CEO, MD & Director

Yes. Look, we haven't set that other than to say we're a dividend stock, and we've reduced the dividend payout in the last year to make sure we stay in a very strong capital position. But over time, we'd like to see that come back up. We haven't had a discussion as a Board, recent time, about what that payout ratio will be. But over the next probably 12-odd months, we will -- I would like to see us come through the next 12 months before we get too excited about increases in dividend. But over time, it has to go -- it's got to go up. That's the form of stock we are. So at this point, comfortable where we are until we get through the outworkings of COVID, and then we'll be doing the review.

Gary Andrew Lennon
Chief Financial Officer

I think way to think about without giving any numbers, but we would like to build it up over time assuming performance improves and -- and then ultimately get to a sustainable position where we're still generating capital on an organic basis at that level of dividend payout. So that's the -- I'm sure you can come up with your own numbers about, well, what level that is, and that will give a bit of a sense probably what we'll start thinking about.

Operator

The next question comes from Brian Johnson from Jefferies.

Brian D. Johnson
Jefferies LLC, Research Division

First of all, Ross, it's rare that I congratulate someone in difficult times of actually at least having a pathway for future improvements. So well done on that front.

Ross Maxwell McEwan
Group CEO, MD & Director

I'll take it from you, Brian. So thank you.

Brian D. Johnson
Jefferies LLC, Research Division

Well, it's to be commended because I think you've had a great markets result and you've pumped up your balance sheet provisioning, which is really quite sensible.

Two questions if I may. First one is, if I go back to Slide 24 from the last -- first half result and I compare that to basically Slide 30, at the first half result, you said rising capital density. Your base low end was 80 basis points and your high end was 180 over the next 2 years. When we move through to this result on Slide 30, I can see that the deterioration over 2 years under the key scenarios is still 80 2 years out, even though we're 6 months in. And the high end is 140. But when I look above, I can see that there's been 40 basis points consumed over the short term. Can you kind of reconcile those numbers for us, please?

Ross Maxwell McEwan
Group CEO, MD & Director

Great. Now I've got to give that straight to you now.

Gary Andrew Lennon
Chief Financial Officer

Thanks, Brian. And yes. And as I went through on the -- as we're seeing things play out and run various models now that we've brought that 140, 180 on top end down to 140.

Brian D. Johnson
Jefferies LLC, Research Division

Is that just the 40 basis points that's been consumed, Gary, there?

Gary Andrew Lennon
Chief Financial Officer

No. So it's -- that's the equivalent range from the previous disclosure based on what we now know. So the way to think about it is the 40 that you see is part of the 80. So we've already -- so we set those at March. To date, we've seen 40 come through of that 80. That is the best way to think about it.

Brian D. Johnson
Jefferies LLC, Research Division

So we're 6 months in to 2 years, and in the future, the low end is another 40 basis points and the high end is basically 100. Is that the way I should read it?

Gary Andrew Lennon
Chief Financial Officer

Yes, that's the way you should read it, with one catalyst or one catalyst, so yes.

Brian D. Johnson
Jefferies LLC, Research Division

Well, Gary, I feel like taking away my compliment because I think you could have expressed that even more clearly in those slides. Now the second question that I had is...

Gary Andrew Lennon
Chief Financial Officer

And [indiscernible] Brian, I'm just going to add one point, which, again, I've taken the note. We'll express more clearly, so we're onboard on that, is that what we have seen that surprised us, which I've talked about already is that there has been upgrades this period. And that 40 of deterioration is the gross downgrades. There's been some offsetting upgrades. What we don't know yet about those but we've kept the range at 80 to 140 because we don't know whether those upgrades we've seen to date is that a temporary [aberration]. Once support gets taken away, will those upgrades go off? But it's just a bit of asterisk, if you like, to that 40. But now that you've got it, that's the way to think about it, 40 against the 80-140 range.

Brian D. Johnson
Jefferies LLC, Research Division

And Gary, how do I reconcile the credit risk-weighted asset increase? Is that from the levels where it was 6 months ago, the $37 billion and the $65 billion? Or is that from where it is now?

Gary Andrew Lennon
Chief Financial Officer

No, that was for March. Yes.

Brian D. Johnson
Jefferies LLC, Research Division

Okay. So you've given us the September figures, but the $37 billion and the $65 billion is from where it was at March.

Gary Andrew Lennon
Chief Financial Officer

Yes. And I take onboard that could be a bit confusing.

Brian D. Johnson
Jefferies LLC, Research Division

Gary, we're in 100% of agreement on that. Okay. On to the next question if I may. And Ross, this is probably one for you, is that if I do some mucking around and I go into the actual profit release and have a look on Page 70, I can see that, in this half year, you had $539 million of new impaired assets emerge in quite a troubling economy. Want to go back and have a look at the half before it was $553 million, and even the half before, it was $807 million. When I actually have a look at that rate of decay in your book and I compare it as relative to gross loans and advances relative to each of the other major banks, it is markedly lower. That's despite the fact that proportionally you have less housing.

Now I had thought that's because the formation of bad loans coming through from your SME skewed book is just so much lower than insto, which is just totally the opposite of the conventional wisdom. But could you just explain to us why, over the longer term, NAB's rate of formation of impaired assets seems to be so much lower than your peers. So that was Page 70 of the result, 9, which is asset quality on Page 70 of the result.

Gary Andrew Lennon
Chief Financial Officer

So Ross, why don't I have a go -- start, and you might want to make comments. Because certainly, the reason why we're not seeing the level of impairment increases is what we talked about earlier. And we have been -- I think we've all been somewhat surprised but not totally surprised, and this goes back to the level of support in the system that we're not really seeing the true pressure yet on our SME portfolio, and we're not really seeing the new impaireds flow through that we thought -- we would have thought have been flowing through.

Now I actually would have thought that's a bit of a sector-wide dynamic, but that's why our new impaireds are quite low this period when you'd probably expect them to be a lot higher. The whole proposition of -- is this going to impact SMEs more than institutional and corporate customers, I think it's still too early to call that as to whether that is going to end up being the case or not. And to date, I think the top end of town has fared particularly well. Their ability to access funding and equities been -- it's been particularly good, so they've been able to get through it so far. But you don't -- as we all know, you don't need too many impairments at the top end to create some pretty significant pain.

Whereas at the SME end, a lot of this has been masked to date with the level of support in the system. And if anything, because of the amount of liquidity in cash, all of our models are saying our SME portfolio is improving, not deteriorating in a lot of respects. So it's just an interesting time currently that I think the next 6 to 12 months will give a clearer picture about where those impaireds will actually be.

Brian D. Johnson
Jefferies LLC, Research Division

Gary, sorry, I apologize. I obviously didn't ask that question very well. What I'm more interested in is even pre-COVID, this has certainly been the case for 3 or 4 years. Why is NAB's formation of impaired assets so much lower as a portion of your loan portfolio than the other banks? Now we know you've got less housing that you would think that would actually make it higher. You've got more SME lending. You would think that would actually make it higher if you followed the traditional literature. But in Australia, your impaired asset formation is so much lower. Ross, have you got any thoughts as to why that might be?

Gary Andrew Lennon
Chief Financial Officer

No. It's something actually, Brian...

Ross Maxwell McEwan
Group CEO, MD & Director

Can I add on funding? You pick up on [that].

Gary Andrew Lennon
Chief Financial Officer

Okay. No, I know what he's talking about.

Ross Maxwell McEwan
Group CEO, MD & Director

The piece that I think we need to examine is what part of our business book is actually secured or semi-secured compared to others as well because a fair portion of our SME book is either secured or semi-secured. So that may give us a tilt as well, is that we've got a high percentage -- and I don't know whether we have or not. If we do, that actually would be a better outcome for us than others but where I'd also go to. Gary, you [want to add]?

Gary Andrew Lennon
Chief Financial Officer

Yes. No. I'd take you to Slide 82, if you can, Brian, in the pack. That might give you a bit of a view of this. And there's some other data points we'll point to as well around commercial real estate. But from a macro risk setting, risk appetite perspective, we've been working for a long time. You'll see on that chart there that back in '09, we had -- 27% of the portfolio had a probability of default greater than 2%, and we have been actively trying to reshape that portfolio over many years to minimize that greater than 2%.

And as we went into COVID, that was down, you see, with a low point of 11%. So it's more than halved what it previously was. And that has been a very conscious longer-term strategy that Shaun's put in place with the business for a number of years with David Gall's help of course. And so that's why I think you've seen that trend over a number of years, and that's why our impairments statistics did improve rapidly.

You'll also see our proportion of our portfolio for commercial real estate -- Shaun, I might -- is about 17% deposit. That's [high at] the GFC, and it's now about 10% of GLAs. So that's a massive shift in derisking the portfolio.

It cost you on the growth side. It cost you on the revenue side, but we think it's the right way to reset it. And Brian, what you've called out is the benefit on the other side of those costs of derisking the portfolio in a sensible, gradual way over what has been essentially a decade. Is that helping out?

Brian D. Johnson
Jefferies LLC, Research Division

It just seems to me you've got a higher, stickier margin and you've got structured lower loan losses. So it's just a very valuable business. But that could be -- I could be wrong.

Ross Maxwell McEwan
Group CEO, MD & Director

And it is around the restructuring that's happened over a long period of time on the portfolios.

Operator

Thank you. At this time, we're showing no further questions.

Ross Maxwell McEwan
Group CEO, MD & Director

Thanks very much. So I'll just make a couple of closing comments. First off, thanks very much for joining us on the call. A good set of questions as well. Thanks, Gary, and the team for putting the session together. And look, 2020 was a year for us of building balance sheet strength. You've seen our capital. You've seen our liquidity. You're seeing now the impairment provisioning. It's very, very strong for this bank. And that's what we wanted to achieve in 2020. We want to hold on to that next year.

I've said very clearly, there's no better place to be operating out of Australia and New Zealand. We are the business -- biggest business bank in these markets. And that's our job to step into these markets and help the recovery. The government has done an outstanding job to date on building -- helping businesses and individuals get through. And now we need to build on that strength. But we have a very clear strategy. And we just have to have the discipline now of delivering against that and growing safely in this marketplace.

So thanks for joining us today. I'm sure we'll get an opportunity to chat over the next few weeks. And it looks like the Victorian economy is starting to get moving again, which is also very good for our business. So good to catch up today. Thanks, Sal.

Operator
Thank you. That does conclude our conference for today. Thank you for your participation. You may now disconnect.