TRANSCRIPT

Transcript: Commonwealth Bank of Australia

Half Year Results – Media Briefing

13 February 2013

Bryan FITZGERALD: Well good afternoon everyone and thank you for coming along to the presentation of the Commonwealth Bank's half year results to 31 December 2012. First up Ian Narev will give us an overview of the results and then we will take some questions, and Ian and David Craig our Chief Financial Officer will be available to answer the questions for you. Thanks Ian.

Ian NAREV: Thank you very much Bryan and good afternoon to all of you and thank you for joining us either in person or online or via phone for a discussion on our results for the period ended 31 December 2012. During the six months that are the subject of this profit announcement we had statutory profit of $3.661 billion, so that is up 1%. Our cash net profit after tax which you will recall adjusts the statutory net profit for certain one offs, particularly around hedging and interest volatility is up 6%. Our return on equity on a cash basis is at 18.1%, our cash earnings per share up 4% and our dividend per share up 20%. Now the dividend per share number as many of you will know on a growth basis looks a bit inflated because it reflects the change in dividend policy which we announced six months ago where we said we would smooth the payout ratios between the first half and the second half. So as we have mentioned in some of our releases today it is likely as a result that the second half dividend will be a little lower than last year.

The overriding message here for us in the announcement is that we have really stuck to the same themes that we have talked about for a number of years and we consider that these themes have continued to enable us to do a good job for our customers and our shareholders in this period. And they really are sticking to the focus on the customer and really keeping our focus in our technology investments and on productivity.

Before I go into those major strategic themes, just to call out some of the key aspects of each business unit's results for this period. Our Retail Banking Services business had a cash net profit increase of 13%. That was driven by good income performance at 5% and very careful management of expenses at 2%. And that is particularly good from the Retail Banking Services' perspective given that we have continued to absorb the ongoing amortisation of our core banking modernisation program and have still kept expenses to 2% relative to the prior comparative period. Offsetting that in the retail bank is deposit income is down 11% and this is a theme which we talked about a lot this morning and I suspect we will cover again this afternoon which is an important theme right across the Commonwealth Bank Group's result. Although the overall market for deposits continued to grow pretty strongly and we roughly held market share, the fact that in the Retail Banking Services business we see deposit income down 11% is an indication of the very strong competition which continues in deposits. So markets up, market share is constant, but deposit income well down and that is a function of the significant reduction in deposit margin.

That same effect can be seen in the Business and Private Bank which is down 4% in cash net profit after tax. Overall business loans actually on an average basis did pretty well over the period so they grew 3.5% relative to the prior comparative period. But as you can see in the results that does not translate as well into the overall banking income for the business again because of this impact of the deposit margins in the Business Bank.

Expenses were held flat, and this again must be seen in the context of the fact that they had roughly a 2% to 3% expense increase just from the core banking modernisation amortisation, so in fact there was real productivity benefits, about 3% there. And our equity in margin lending business was down 15% on the prior comparative period. And that is a function of the fact that although the CommSec business in particular continued to hold share well and continued to manage its yields well, overall level of trading activity in this period was still pretty low.

Our Institutional Bank and Markets business grew its cash net profit at 6%. Overall operating performance was up 15% and one major driver of that was the counterparty valuation adjustment. This is something that we talked at some length about in the last half and it relates to the way we have to assess the credit risk of our counterparties in the market business, and in the current interest rate environment and the current credit spreads environment that improved, and that resulted in $82 million turnaround relative to the prior period. At the same time and again to repeat the theme now in the third business net interest income is down 7% and again that is showing the effects of the lower margin on deposits.

Our Wealth Management business six months ago and certainly 12 months ago there was a lot of discussion about did we really have an appetite for this business and at the time we said we feel we have got a very good collection of businesses and assets. But obviously when markets are not good these businesses tend not to perform. Over the period that we are talking about markets were stronger and the Wealth Management business accordingly grew its cash net profit after tax of 10%. A really strong aspect of this result was that net flows are up $6.5 billion and that is the strongest performance in net flows we have had in five years. And at the same time as flows were good on the asset management side we continued to see good overall investment performance from our Colonial First State Global Asset Management business. And those things together with continued good policy income flow in insurance resulted in net operating income being up 10%. At the same time in that business expenses were up 9% relative to the prior comparative period and at a headline rate that is not a number we would want to see continuing. That needs to be seen in the context of first of all some ongoing additional expenses from the Count [Financial] acquisition relative to the prior comparative period. But probably most significant are the ongoing costs in this business of meeting the new regulatory requirements, future financial advice etc. And on the more normalised basis adjusting for those two effects as you will see later in the materials, Wealth Management's expense growth was actually closer to 3%.

In the case of the New Zealand businesses and our BankWest business we continue to see good operating performance. In ASB, good management of margin and continued focus on productivity meaning an improved cost to income ratio down 140 basis points with a slight increase in loan impairment expense. The BankWest business income growth slightly lower than the Group average of 2% primarily as a result of less Business Banking activity as it continues to work through its Business Banking book, ongoing attention to expenses resulting in expenses being down 3% relative to the prior period. And then quite a significant increase relative to the prior period in loan impairment expense, up $48 million. Now that delta of $48 million is the key driver of the Group's overall loan impairment expense being up 13% relative to the prior period. But as we point out on this chart the key element of this is that now in this half the actual loan impairment expense is 23 basis points of assets, and that is actually at quite a normalised level compared to 22 for the Group overall. So the increase is much more a reflection of the fact that the previous period at 6 basis points and 11 basis points have been particularly low.

And on top of all these businesses we continued to make progress exactly as we had hoped to in our International Financial Service business with continued build out of the business, the proprietary businesses in Indonesia and China and good performance of our investments, particularly Guangzhou Bank in China.

To come back to what I said a little earlier, the main message for us of these results is that we have stuck to a long-term strategy and it has continued to pay dividends for our shareholders at the same time as underpinning record levels of customer satisfaction. That all starts with our people; and although we do the people engagement survey around this time of year, we do not have a new one for this half, what we can say is that the levels of engagement of our people remain very strong, and actually I would say are continuing to improve. We are paying a much greater attention to this at Board level and Executive level and right through the leadership of the business. And our people are responding very well not only to the continuing focus on the customer, but to the fact that we have stuck by our commitments not to be sending Australian jobs offshore and also not to be managing towards head count targets. And we have seen that despite the fact that we have made those commitments we have still managed to get good control of expenses in this business and that really is a result of our productivity initiatives.

If you have got engaged people that does underpin ongoing strong performance in customer satisfaction and that is what is seen here. So you can see on both the Retail and the Business side that the satisfaction of the Commonwealth Bank's customers is higher than the average of our peers. In the Roy Morgan survey which is the key survey for retail banking customers, as of the last result which was in December our customer satisfaction is at an all-time high. And the gap between CBA customers and the number one in the market, we are currently number two, is 40 basis points which is the lowest in the Group's history. And around about 2006 when we really started the customer satisfaction endeavor, that gap to number one was above 12%. So we have gone from above 12% to less than half of a percent, and that is as a result of engaged people sticking to their focus on the customer. In business customer satisfaction we remain well ahead of our peers and in the DBM survey we are number one or first equal in all the business customer segments.

Through the period we have continued to invest in technology and this is a long-term theme of the business and something that we will continue talking about in some detail period on period. One of the most important aspects of where we currently stand in our technology investment program is that the Core Banking Modernisation program which has been the primary focus of the Group's investments for the last six years will come to completion in the half that we are now in. We are obviously still very focused on the next couple of months but assuming a successful migration of our commercial lending customers in March and April, that program will then be completed. And that is something which we have been focused on for six years. Particularly pleasing for our Retail Banking Services [business], next financial year will be the first year in quite some time that the combined impact of the operational expenditure and amortisation of the core banking program will be less than it was the previous year. So that project will have been completely delivered within the scope and the time that we wanted it done and we are now very focused on extracting the benefits.

But importantly our technology focus is well beyond that individual project. And just in this half in the last few months you have seen an example, many of you may be aware, we launched the mywealth.com.au platform which is a category leading self-directed investment platform launched through our CommSec business, our Equities and Margin Lending business. We have continued to focus on improving the ability of all our customers to get advice and assistance on all our products through all our thousand-plus branches. So by the end of June all thousand-plus branches will have video conference capability in them and being used and that enables delivery of specialist advice in areas like Personal Lending, Wealth Management and Business Banking to be delivered from experts who are sitting in Sydney and elsewhere to people who are in branches in all regions.

And finally as many of you will have seen in our Investor Relations App which was launched a month or two ago, the focus on how we can use technology to improve the effectiveness and efficiency of our business is by no means limited to just the customer facing businesses. You can see it right through the Group and in this case in our Investor Relations business.

One of the common themes we have had in terms of our technology investments has been what is the impact of the big amount of effort we have put in the Core Banking Modernisation Platform. And one aspect of the capability that we have called out consistently over a period of time is the fact that 24/7 real time platform will provide distinctive advantage to our Retail and Business Banking. That is meaning if you have got money and you deposit it in the branch today you get value from it from that minute and you can use it from that minute. And we remain the only one of the major banks that is able to do that across the whole of the Group.

You can see that is starting to show benefits in terms of the uptake of transaction accounts which is one of the key areas of differentiation. RBS personal transaction accounts up 13% relative to the prior period. Transaction account balances up 9%, 8,000 new transaction accounts in the business and private bank and as you can also see it is being used in the institutional bank and markets business to support the winning of new institutional mandates.

Over the last couple of profit announcements we have talked a lot about our efforts in productivity and again we are seeing the benefits of that focus on productivity turning up in the business. And below the headline expense management of 3% relative to the prior comparative period you can see here at a much more granular level the sorts of areas where that focus on productivity is turning up. And to focus specifically for a minute on the top left part of that chart in the retail branch network, you are seeing that transactions per customer service representative grew at 6% relative to the previous year and sales and converted referrals per customer service specialist grew 16%. And to give you an example of the sort of capability that is underpinning that, we now have the capability for branch managers each week to have a look at the traffic patterns within their branches, which hours of which days customers are coming in, what sorts of activities they are doing, and every morning to configure their roster to make sure that they have a large number of people in the branch at front of house when the customer traffic is highest. And when it is lowest have those people being able to do other service for customers who are not in the branch. And that sort of capability has underpinned what you see here. And that is just one example of how the productivity focus is giving us benefits across the business.

And finally in terms of our strategic capability we have continued to make sure that right across our balance sheet we have focused on long-term strength. And while in the case of many of these settings it could be a little bit cheaper and in the short-term more profitable to have more aggressive settings, we very much are of the view that the settings we have on the balance sheet on all these metrics must be right for the long-term and must enable the Group to be able to weather any unpredicted downturns in the market.

So you can see here that we have continued to grow deposit funding as a proportion of overall liabilities on our balance sheet so that is up to 63%. Critically here you can see in our wholesale funding tenure we have continued to keep a long-term weighted average maturity on the portfolio of 3.7 years. And you can see here that in this period we continued to increase the level of new issuances, the term of the new issuances to 5.3 years. It is very important to dwell on this point for a minute on the issue of funding costs because there has been a lot of debate about whether month on month funding costs are coming up or down. What this chart shows is the average funding that has been replaced during this period was roughly five years old. And that means that we put it on our balance sheet towards the end of 2007. And the cost of that funding in 2007 relative to today was still significantly lower. So we are replacing lower cost funding still with higher cost funding. And that pattern remains really until

we get to funding that was put on the book after September/October 2008 which was the time of the Lehman Brothers crisis which really spiked the funding.

So it is very important to understand here that although we are happy to see funding costs month on month at the moment coming down in terms of a marginal cost basis, the fact that it is still more expensive now to fund than it was with the time we actually put the funding on the book the first time means that average funding costs continue to rise albeit not a great deal.

On the bottom left we can see that in total provisions to credit risk weighted assets the Group has maintained very good levels of provisioning relative to peers. And on both liquidity and capital we have maintained conservative settings. So despite the fact that if anything over the last couple of months volatility has come down a bit, we have increased the overall level of liquids to $128 billion, and we have maintained very strong levels of capital. So 10.6 on a Basel III globally harmonised basis relative to 9.8% in June and 9.3% a year ago.

Turning now to the outlook. Clearly we still do not have a crystal ball here. If I think back to the sorts of discussions we were having six months ago and 12 months ago there was a lot of global uncertainty really driven out of three areas. Number one was that there was a lot of discussion about Europe and in particular what was going to happen with Greece, Spain, Italy etc. and the future of the European Union causing a high degree of uncertainty. Number two, we were a few months away from an American election, uncertainty around that election around the fiscal cliff, and uncertainty about the ongoing growth and resilience of the US economy. And number three, we were pre a leadership transition in China and there was a lot of concern about what the leadership transition may or may not do to underlying growth in China.

As we have seen over the six months since we last talked about those subjects the overall global trends have been positive. Certainly in the case of the US and China the degree of uncertainty around political change etc. has gone right down as we now understand which governments are in power and what they are going to be doing. In the case of Europe, what we have seen over the past few months is at least no more shock news and that has been very important. I think most of us feel that the long-term answer for the future of the European Union and in particular the retiring of sovereign debt is unsure. But the level of shock likelihood seems to have come down and that has created less volatility in the global markets.

Our core base case is that that level of volatility will remain lower and as it keeps remaining lower month on month we will see a slow and steady rebuilding of confidence in the Australian economy from both consumers and businesses. And part of the equation here really is just time, making sure that month on month people feel like there is more stability in the environment they are operating in which in turn will create greater confidence. And our opinion as you may recall for quite some time has been the fundamental underpinnings of the Australian economy have been strong, and the key challenge has been the restoring of confidence. And as long as the global volatility remains lower we feel good that that confidence will slowly and steadily return.

Of course as a major financial institution we need to be cognisant of downside risk and we need to be prepared for that base case not being right. And in the longer term one of the forces which occupies our mind to a significant extent is the long-term effects of all the work that has been done by central banks overseas to restore stability. Long periods of low interest rate, buying back of public debt etc. are possibly going to cause in the medium to long-term longer global inflationary effects and that is something of which we all need to be cautious. But again we are expecting and certainly hoping for a slow and steady rebuild of confidence.

In terms of what that means for us in the Commonwealth Bank Group we will stick to the consistent execution of the long-term strategy. And as I said earlier what we have seen in this result is that that focus on the customer,

that focus on technology investment, that focus on productivity has enabled us to have good revenue growth in the context of the environment. Keep investing, we invested $582 million in the half while still keeping expenses under control. Keep lending well, because we have got stable credit quality as a result of long-term conservatism. And keep providing good balanced returns to our shareholders at the same time as doing the right things by our customers. So we can see that the strategy is delivering results and we believe that sticking to the same strategy will position us very well to meet the interest of our customers for the long-term and to give us long-term competitive advantage. I will now hand over to you Bryan to chair the question and answer session.

Bryan FITZGERALD: Thanks Ian. Just some housekeeping before we go on to the questions and answers. Could you wait until you get the microphone so our friends on the line can hear. Could you please identify yourself and where you are from, and limit your questions to two so we can try and get through them all thank you. We will go to John Kavanagh in the middle of the room.

John KAVANAGH: Hello, John Kavanagh from Banking Day. Ian, just looking at the net interest margin, in retail banking it went up and the description there said that there was a recovery in margin across the lending portfolios as a result of repricing. It also went up in the New Zealand business. But the margins in Business Banking, Institutional Banking and BankWest were down. So would I be correct in reading that as that the retail customers bore the brunt of the repricing?

Ian NAREV: Not that the retail customers bore the brunt of the repricing. The important aspect of the net interest margin is as per the term it is a net interest margin and what we see here is the relative impact between what is happening with home loans and what is happening with deposits. And if you have a look in our materials on page 37 which shows a long-term view of the Retail Banking margin you can see that although it has recovered a little bit in the last six months and a little bit in the last 12 months it is actually a lot lower than it was 18 months ago. And particularly if you go back to pre-GFC times, 2006, 2007, it is significantly lower than it was then. So the competitive market for retail deposits, retail home lending, business deposits, business lending, all work quite differently and at any given six months that might mean that the particular margin impact in any business is a bit different. But they by no means have borne more brunt than other customer segments.

John KAVANAGH: So did you have repricing in Business Banking and in Institutional Banking? Because it looks from the margin as though you didn't?

Ian NAREV: No we have continued to do what we have done for a long period in Business Banking which is keep pricing to the market so it is not such a matter of repricing but we do what we do in our home loans which is assessing the competitive market, customer demand and what is happening in our funding costs and reach the conclusions we do on the pricing.

Bryan FITZGERALD: Thank you. We'll go to Andrew Cornell from the AFR who is on the telephone.

Andrew CORNELL: Thanks Bryan. Two questions. Just to continue John's on the funding mix there. You talked about how the trough for the low funding costs was '07 and then obviously it spiked up in '08. So does that imply that along with the improvement of trends we have seen in recent months you are actually going to start to get a significant improvement in repricing of that funding towards the end of this year as that '08 stuff starts to get replaced by much cheaper lending? And hence can you then pass that on to customers?

Ian NAREV: Yes, Andrew there are two effects here that are most important when we are talking about the funding costs. Number one, is the relative cost of replacing the funding that is rolling off. And that is part (a) of it and as I said earlier exactly as you say for the next nine or 10 months assuming like for like term funding

that is still going to be a little bit more expensive than the funding it has been replacing. That is number one. And then number two, is a funding mix question and that is where the whole deposit pricing issue comes in.

Now what we have seen in the last several months and over now quite some period of time is as a result of lessons from the global financial crisis, views of rating agencies and regulators, all the banks have seen fit to compete hard for deposits and the beneficiaries of that in our case have been 10 million deposit holders. It is impossible for me to predict as I sit today what the competitive environment for deposits is going to look like. That is going to depend on the actions of not just the major banks but a large number of different competitors in that market. At the same time while I hope and at this stage expect that the trend that we have seen in recent months with wholesale funding costs will remain, we are all aware that there are shocks in the market which could cause a spike in the wholesale funding costs. So as we sit today the proportion of our balance sheet which is funded by term wholesale funding Andrew, would start improving in about six to nine months' time.

David CRAIG: And that is about 20% of the balance sheet.

Andrew CORNELL: And just a second one. You spoke about the impact of the CVA and six months ago you said oh you know, it's taken a slice off the profit, this time it's added 82. And you said at that point that this is something that's going to become more significant as there's less volatility and less growth in the overall market. So in 25 words or less can you explain the CVA to me, and speak slowly so I can write it down?

Ian NAREV: Yes I will. We help our customers particularly in Institutional Banking with certainty by enabling them to swap interest rate risk. Effectively say, if they are borrowing, say "We want to fix a rate, and in exchange we want you to give us a floating rate" and that creates, we achieve that by giving them some hedging. If the hedge moves effectively to the area where they would end up paying us money we take credit risk on that party and we need to make an assessment of the credit risk of that party. And when the environment is more volatile and when the environment is more turbulent, that credit risk blows out and you can see that actually the CVA goes up. At the same time generally given the nature of our book when interest rates are coming down, more of the swaps are effectively resulting in clients owing us money and that results in that overall level of credit risk going up a bit. So the best way of thinking about it is it is like a collective provision on that swap book that we have with our institutional clients so that was not anywhere near 25 words but I hope it addressed your question.

Andrew CORNELL: And it will still be a big contributor to volatility in the foreseeable future?

Ian NAREV: Well as overall volatility goes down (a) the demands of these swaps tends to go down a bit and (b) the relative movement of credit spreads over the period tends to go down a bit as well. So if volatility in the overall market is lower we would expect the volatility in the CBA to be lower as well.

Andrew CORNELL: Okay thanks.

Bryan FITZGERALD: Thanks Andrew. We will go to Stephen McMahon on the phone and then back into the room to Ross Greenwood.

Stephen MCMAHON: Ian how you doing? Just a quick one for you. I mean you've handed out another record profit growth and I just wanted to see do you, you're actually talking about this sort of net interest

margins coming down and wholesale funding still being fairly high, but do you appreciate sort of how the community fails to understand why you don't pass on interest rate cuts but yet hand down even bigger and bigger profits on a six monthly basis and how are you going to go around explaining that? And I suppose, do you feel you are successfully explaining it I suppose is the real question?

Ian NAREV: Well number one Stephen, it is an absolutely legitimate question for people to look at a large institution earning, you know, over $3.5 billion of profit in a half and saying that is a big amount of money; and that is particularly relevant when you are a customer of a big institution and you have been living in a more difficult economy and you are finding it hard to pay your home loan. So we absolutely understand that and we absolutely expect this line of questioning.

What we keep trying to explain is that the important thing for us is to think long-term and to balance the needs of those 1.8 million lending customers with the needs of 10 million deposit customers and equally with the needs of 800,000 Australians who own our shares directly and millions more who own them through pension funds. And achieving that balance is a very difficult task. It is something we are focussed on very much for the long-term and when we are striking that balance it is inevitable that at any point in time one of those groups of stakeholders will feel that their voice is not being well enough heard. So you will never hear me, and I hope never hear anybody from the Group, say there is no legitimate basis for this question. What we do say is that we understand it but we need to keep achieving this balance and that is something that we remain focused on.

Stephen MCMAHON: And who do you think is the voice that's not being heard at the current moment in your balancing act between those three parties?

Ian NAREV: Stephen, in all honesty I can tell you I have had home loan customers tell me they think the rate is too high, I have had deposit customers telling me they think the rate is too low and I have had shareholders as recently as the recent AGM tell me they think the dividend is too low. And so I think there are always people within all those segments who feel that there is not enough in what we are doing for them and that is something that I understand but unfortunately I need to realise in my role that it is impossible for me to please all those people at one time.

Stephen MCMAHON: No problem, thank you.

Ian NAREV: Thanks.

Bryan FITZGERALD: Thanks Stephen. Ross Greenwood.

Ross GREENWOOD: Yeah Ross Greenwood, the Nine Network. Given your response and given your commentary about funding costs, also given your comments about customer satisfaction and how the customer is a priority, I just want to go to one aspect of your business and that is your variable rate home loans. Your standard variable rate home loan right now sits at 6.4% but any customer worth their salt knows that you'll knock 1% off that. So why therefore not be transparent and tell the customer what the real price of their home loan is as distinct from having what I call an 'illusory' home loan rate which is not relevant to most of your customers these days when the real price, and indeed your customer's price, is almost one percentage point below that?

Ian NAREV: Well Ross, you will probably be aware that the only function of the standard variable rate is to set a transparent benchmark by which we can set every individual home lending rate. So everybody's rate is relative to the standard variable rate. And I do not think there is any customers, I hope there is no customer who would say we have not been completely transparent to them about their rate. We describe it by reference to the benchmark rate and that is the rate we talk about in the market. So it is very important for us indeed in terms of the legal framework in which we operate, it is very important that customers understand exactly what they are paying and it is something we are very focussed on.

Ross GREENWOOD: Okay I'll ask a supplementary question; and that is therefore why would you have that benchmark rate? So it's not a standard variable rate, it's not a rate you'd expect your customers to pay, so why would you set that rate so high and technically out of the market, out of the money as it were, as distinct from bringing it down perhaps closer to where the real rate that your customers are paying is?

Ian NAREV: Well number one, we set the rate above all in response to a highly competitive market and what you will see is that if you look over the last 18 months we, more than any other, we have passed on more reductions to that standard variable rate than any other major bank. And the thought that is often lost in this debate, and if you walk around our branches as I do very regularly and speak to any of our people, all of them feel they are competing very hard against the other major banks for home lending and indeed the non-major banks who have grown even faster than the major banks according to the RBA numbers in the last six months, and that is the structure under which the banking system operates and we all price to it. But we are still very keen to get good customers in a way that creates a fair price for them and value to our shareholders and that is something we are very focussed on.

David CRAIG: Ross, can I just answer the question one other way too. If you look at your mortgage, assuming you have one, you will see that it says in your mortgage your pricing will be some discount off the standard variable rate. So if the standard variable rate suddenly became a different thing then all of the mortgages currently out of the market would need to be rewritten because the legal agreement with the existing customers would change. So we are sort of locked into having a standard variable rate because it is the legal baseline upon which all existing mortgages are priced.

Ian NAREV: The other thing I think that is very important to bear in mind Ross, is that customers who prefer absolute certainty always have the option of a fixed rate and that does not move over the period in which they do it and that is something which many customers want to talk about.

Bryan FITZGERALD: Thank you. We will go to Narayanan from Bloomberg on the phone and then we will come back to Tony Boyd and Clancy Yeates.

Narayanan SOMASUNDARAM: Thanks Bryan. Now I just want to check you've seen several issues of RMBS transactions and hybrids so I was just wondering what's your plans for those two markets?

Ian NAREV: Well we have already priced a large hybrid late last year so we are sort of topped up. You can only have up to a certain amount of hybrids at any point in time on your balance sheet, you know, that account for capital and we are full on those. On RMBS we did an RMBS late last year I think and we will obviously as the market gets fresh and the rates are coming down we will do more of that if it is cost effective at the time. It tends to be a much better instrument for the smaller banks than the banks with higher credit ratings, better credit ratings.

Bryan FITZGERALD: Tony Boyd.

Tony BOYD: Hi Ian. Just following up what David was saying, there's recovery in the RMBS market. Mark Boris, who's funded by Macquarie Bank, says that the record numbers you wrote in January were most of them were customers from Commonwealth Bank refinancing. Now I don't know if there's any truth in that but do you see the recovery in the RMBS market and the ability of these people to get funding cheaper than what they have as a bit of a threat to you?

Ian NAREV: Well number one above all else we welcome the competition because it keeps our people on their toes and it makes sure they are doing actually the right thing by customers. What I have noticed is given that we are the number one mortgage lender in Australia is that everybody in their results when they are talking about home lending seems to be gaining share from the Commonwealth Bank Group and yet our overall numbers cannot be consistent with that because we are not losing nearly as much share of the aggregate of what everybody claims. So we, given the quality of the service that we have got and the job that we are doing for our customers we are very comfortable with how we are going. If he is disproportionately getting Commonwealth Bank Group customers, then that is very much at odds with what we see in our systems.

Tony BOYD: Just one other question about technology. Now that Michael Harte's finished this project, or about to, I just wonder what's the next big thing? We see Telstra's buying into a sort of whole apps development business and a lot of Australian companies are trying to sort of find the next stage of technology development and I just wanted to ask where you might go and secondly how much capital can you invest in that area?

Ian NAREV: Tony, there won't be a big thing to replace core. Core is the kind of project any management team probably only do once in its management lifetime given its scale and complexity. At the moment if you see in our results I think we spent $582 million in the half and I think about 24% of that was on the Core Bank Modernisation Program and that is obviously investment dollars we don't need to devote to that. That won't be devoted to any single one thing. But the broader way we are thinking about this is that we have spent a lot of time and effort upgrading the Core which is very hard to do and now our focus will go very much to the distribution channels. So our view and what differentiates us from some of our competitors is our view has always been that you cannot have state of the art distribution channels without overhauling the Core. Now that we have overhauled the Core we can make use of that through the distribution channels.

I would also say that there are other parts of the business, and I think about our Wealth Management business, Institutional Bank and Markets where we have probably invested a little bit less while we have been investing in the big core bank modernisation overhaul and they will be due for a bit of investment over the next couple of years as well.

David CRAIG: Tony if I could just come back to your earlier question on refinancing. On slide 81 of our pack, we have disclosed that mortgage re-pricing was about $3 billion which is around about 1% of our book was externally refinanced. And there is also a graph there that shows how that compares to prior years and that is below most of the prior years so we are not seeing any uptick in external refinancing.

Bryan FITZGERALD: Thanks. We'll go to Clancy Yeates from Sydney Morning Herald then to John Durie on the phone.

Clancy YEATES: Hi Ian.

Ian NAREV: G'day.

Clancy YEATES: Just another question on funding costs. In the earlier briefing you said that this debate wasn't going to go away any time soon. I'd just like to ask you what does that mean for your many customers? Does it mean that the war for deposits, and therefore this debate about mortgage rates, is just going to go on indefinitely or is there some point in the future when, you know, it'll stop?

Ian NAREV: Look it is really hard to pick. What we have seen over the last few years is there has been a lot of volatility in the markets. That has created bigger different spikes in funding costs and that has meant this has been more of a debate than it has been previously. And what we would expect is that once the volatility is less we are going to get back into an environment that people maybe understand better and that the debate would die down a little bit. Now that said, I have had the privilege in my time in the role to speak to three or four people who were Chief Executives of the major banks in the 1980's and they have told me that they recall exactly the same debate happening when they were presenting their results and they were talking at that time. So there are elements of this which are just reflections of the fact that we are a big institution, we deal with issues which are very important to people, and they are sometimes really complicated and we don't always do the best job of explaining them simply. And we keep trying to explain it better and more simply and maybe one day we will succeed at it better.

Clancy YEATES: And can you see the day when a bank might be in a position to cut its mortgage rates more than the Reserve Bank or without the Reserve Bank also cutting rates?

Ian NAREV: Look as you know I am not allowed to say anything in terms of future prospects on pricing. What I could say is that it is a competitive market and if we reach a different environment in terms of both the volatility and the cost of funding that is conceivable, yes.

Bryan FITZGERALD: Thank you. John Durie on the telephone.

John DURIE: Hi there Ian. Two questions if I could. Firstly you talked about the benefit you got on the counterparty risk. I think for most of the last half the 90 day bill rate was below the cash rate. What sort of a benefit would you have got from that?

Ian NAREV: Well you can see in the net interest margin numbers in the debt that we actually got a little bit of a benefit in the margin because of a reduction in basis risk.

John DURIE: Sure.

Ian NAREV: And that is largely the impact we get out of what you are talking about which I don't have in front of me but I seem to recall was about three basis points of margin, yeah.

John DURIE: Okay, yeah. So what would that be in dollar term?

Ian NAREV: I could not do that maths on that for you at the moment.

John DURIE: Okay.

Ian NAREV: But it is three basis points of net interest margin.

John DURIE: Righto, thank you. Now secondly, regulation hardly got a mention which must be the first time for a while. Is that a reflection of the fact that you're happy with the way APRA and the Basel people are talking or it's just not an issue anymore?

Ian NAREV: It certainly consumes a lot of our time and as you can see from the numbers a lot of our investment. What our view here on regulation is and will remain is we have got through, despite the fact that the Australian banking system has gone very well through the global financial crisis we have got through a period of a

number of years where the world overseas felt like financial institutions brought economies to their knees, and that led to greater regulation and we completely understand that. And we feel like we have got very good lines of communication with APRA, very good lines of communication with ASIC, very good lines of communication with other regulatory authorities.

We absolutely do not agree with them on every letter of every regulation. We are prepared to have good debates with them. We tend to do that one on one, not in public forums, but overall we accept the context in which the extra regulation is happening and we just get on and do it.

John DURIE: Okay, thank you.

Bryan FITZGERALD: We'll go to Phillip Lasker from ABC TV and then to Caroline Henshaw from Dow Jones.

Phillip LASKER: Ian, what do you think's going to happen to your margins from here on in? Are they going to come under increasing pressure or do you think you can improve them?

Ian NAREV: Very hard to predict. I mean the drivers here are number one what is going to happen on the funding cost side and what we have seen there is we would expect hopefully wholesale funding costs keep going as I have said they were. The factor of deposit competition is really hard to pick because I don't know what is in the heads of my competitors and we are not a price maker in the market, we respond to competitive forces.

Likewise on the lending side, we have been in the competitive market. I have had questions here telling, you know, asking about people outside the major banking systems who are apparently taking a lot of customers off us so that is a sign that competition is pretty fierce on the asset side and that would continue to lead you to believe that the margin carries on being under pressure.

So all in all, the combination of competitive forces and the funding costs suggests that margins, you know, we have got to work really hard just to keep margins where they are.

Phillip LASKER: Are you going to fight hard to maintain market share or do you think you can grow market share?

Ian NAREV: We absolutely think we can grow market share. We have said for a number of years we have got to think both of our customers and our shareholders and make very thoughtful trade-offs between margin and share and they do change over time as competitive conditions and margin conditions change. But we are Australia's largest financial institution, we hold great value in the strong market positions that we have got and we need to be prepared to compete hard to keep them.

Phillip LASKER: One final question. How effective do you think the interest rate cuts we've received so far have been in stimulating the economy and how helpful has it been to banks not to pass on the full extent of the Reserve Bank's cuts?

Ian NAREV: The important thing to bear in mind about the effect of the RBA's interest rate cuts is you really get two effects. Number one, is an immediate confidence effect sort of the days and weeks after it happens. But then the real effect comes through in the real economy over a much longer timeframe. And it is a bit too early to cast judgment on the latter, but I would tend to agree with I think what the Governor said and the Reserve Bank itself said in relation to its last decision, is that we are seeing now the benefits of the interest rate cuts the Reserve Bank has done, and we certainly are seeing the early signs of that helping inject a bit more confidence into the economy. So our current view is that they have worked. We are seeing the benefits of that in

the economy, and bear in mind that our home loan customers, and you can look at the back of our profit announcement for a very transparent breakdown of our income between a volume effect and a margin effect. And you can see from that that the margin effect is still quite negative but that all our home loan customers on average are paying about one percentage point less on their loans than they were a year ago and that is having an impact on the real economy.

Bryan FITZGERALD: Caroline Henshaw from Dow Jones.

Caroline HENSHAW: Hi Ian. I just wanted to ask, seeing as the results from your domestic business is so strong and you've got more profits for it now I wondered if you had any plans to reinvest any of those overseas and if so how and where?

Ian NAREV: Well we already have pretty clear plans in terms of what we are doing overseas and that focuses primarily on what we are doing in our proprietary investments in Indonesia through our PT Bank Commonwealth and PT Commonwealth Life. Through our investments in the County Banks in China and our partnerships in China and also of course what we are doing in our Global Asset Management business and our Institutional Banking and Markets business. So over time given the economies in which we are making those investments they are increasingly contributing to the growth profile of the Group.

We won't double down or make any major investments there unless there is a really compelling rationale to do that. We certainly would not do it only as a reflection of how much growth we did or didn't see in the domestic portfolio. But right now we are very comfortable with the level and pace of our investment overseas.

Caroline HENSHAW: So you don't have any specific plans to make any acquisitions in Indonesia as has been touted in the press?

Ian NAREV: No I mean look there are press speculations on everything from small acquisitions in Indonesia to acquisitions of Standard Chartered. We don't make comment on any of those acquisitions but we have made quite clear how we approach acquisitions and that is we set a very high bar. We need to be able to add capability to anything we buy whether it is small or big and the bar on doing that remains pretty high.

Caroline HENSHAW: Okay.

Bryan FITZGERALD: Okay we've got two last questions. We'll go to Andrew Cornell on the phone and then into the middle of the room and then that's it, thanks very much.

Andrew CORNELL: Thanks again. Just on the, on deposits, one of the impacts of the new liquidity regulation will be a sort of variation in the value of deposits. Are you starting to see that play out in the market yet, you know the lesser attractiveness of hot online for example?

Ian NAREV: Well what I can tell you Andrew is that in the Commonwealth Bank Group, we never talk about the positives generically as deposits for exactly the reason you have talked about. That under the liquidity coverage ratio rules in connection with Basel III the question is how sticky is a deposit and what you really want to do is ensure that you are doing well with deposits which are going to stick with you for a long time and that you are not going to rate chase deposits which are likely to fly out the door on a moment's notice because it is not economic to do it. And that is why when you hear people saying look the world is now all about deposits and you need to just look at our deposit ratio that is not the way we look at the world at all. Whether or not that is yet playing out in the competitive market we certainly have not seen it yet but that is the way that we have been thinking about that internally since we got the first inkling of what the Basel III requirements would look like.

Andrew CORNELL: Thanks.

Bryan FITZGERALD: And the final question thank you.

Leng YEOW: Hi I'm Leng Yeow from the Financial Review. You mentioned a 9% increase in expenses for wealth in part due to FOFA. Can you just give me an indication of how you guys are going with dealing with those reforms?

Ian NAREV: We are devoting an enormous amount of management time and effort to making sure that we implement those reforms well. And as you will be aware many critical aspects of FOFA and other regulation in that area is not yet finalised, it actually still moves around pretty quickly. So I expect that we are going to have a lot of effort devoted to those areas for at least the next year. I do look forward to the time where we are able to say that the regulations are fully known and fully embedded and we can start making investments of time and people in other areas of the business.

Leng YEOW: And just lastly if the government continues to tinker with superannuation how will that affect your Wealth Management business?

Ian NAREV: To tinker with super? Well look our view is twofold on here. Number one, it is absolutely critical to have a long-term and certain view of the superannuation system. I mean this is something which is critical to every one of us individually and to us collectively as an economy. And so we must make sure that in debates about superannuation we don't treat this as a short-term political football to address any short-term budgetary exigencies but we have got to think for the long-term and for certainty and it is very important for the debate to be about the long-term and not to move around. And as we have said before our fundamental view is that 9% is not enough. We support an increase to 12%. There are many different ways of how that might happen and that is a good debate that is going on at the moment.

Bryan FITZGERALD: Okay thank you very much everyone for attending this afternoon.

Ian NAREV: Thank you.

– END OF TRANSCRIPT –