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Introduction

Melanie KIRK: Hello and welcome to the Commonwealth Bank of Australia's Results presentation for the half year ended 31 December 2018. I am Melanie Kirk and I am Head of Investor Relations. Thank you for joining us for this briefing. Today we will be having presentations from Matt Comyn, our CEO, and Alan Docherty, our CFO. I will now hand over to Matt for his presentation. Thank you.

Presentation from Matt Comyn

Matt COMYN: Thank you very much Mel. Morning all. We are six months into our strategy, which we announced in August of becoming a simpler and better Bank. We are very focused on making sure that we are delivering better outcomes for our customers and our communities, better outcomes for our people, and of course better outcomes for our shareholders.

A big part of this of course is focusing and simplifying our business and really focusing on our core banking businesses, where the majority of our earnings are derived, and where our real competitive advantage lies. We also want to make sure that we are delivering the best experience overall, but particularly in digital, where we continue to have the largest and most satisfied digital banking experience in the country. And importantly, we continue to invest in our operational and risk compliance. You will see that quite clearly in our result, which we think is critical for ensuring that we are delivering better customer and risk outcomes.

Overall as you would expect we have been very focused on ensuring we are responding to the failures of the past, and getting to the root cause of those issues. We do not underestimate the work that is ahead of us, and whilst we feel like we have made real progress over the last 12 months there is clearly a lot more work to do. We believe we are making good progress overall on simplifying our business model and against the divestments that we have already announced. And as I said we continue to have digital as a particular area of focus for investment, and ensuring we are overall the leading technology bank.

I think what this result does highlight is the strength of our underlying franchise and the operating momentum in what has been a challenging context. It is certainly not something that we take for granted for a moment. And we have seen that in particular improved performance, volume performance of home lending, and a very strong and very pleasing transaction account and deposit performance overall. And then continued discipline and focus on organic capital generation has seen us deliver a common equity Tier 1 of 10.8%, and maintaining the dividend at $2.00.

As I said, that big focus on ensuring that we are getting to the root cause of those issues and rebuilding trust and confidence in the organisation. I certainly appreciated the more than 14,000 customers who took the time to respond to my letter to more than eight million. There are a number of very clear themes came through that. One of those of course was the demand for Apple Pay, which we announced on 23 January. I think it is really critical in terms of setting the tone and the right culture inside the organisation that both myself, members of my Leadership Team are very engaged directly with our customers. I have been personally involved in a number of the customer issues, we have brought customers into a number of our Senior Leadership Forums, and I think that is going to be a really critical message to send inside the organisation, to ensure we are putting them at the heart of everything that we are doing.

We brought in some smart alerts, helping our customers avoid unnecessary fees and charges, trying to remove some of those real points of frustration that have been expressed to us. Of course we have made a lot of progress against removal of incentives against tellers, but a lot of reform more broadly against sales incentives, a big focus on very clear values expectations for our people, a new Code of Conduct, ensuring that we are there for our customers when they need us most, putting in place a very tailored package for drought-affected farmers.

And you might have seen this morning there was a release of the Promontory Report, which is the independent expert which tracks our progress against the Remedial Action Plan, which is of course in response to the Prudential Inquiry. Overall in what I would say a lengthy report could be summarised as we are on track, we have made good progress in the last 12 months, but there remains a lot of work to do.

Clearly the last couple of days quite rightly has been dominated by the Royal Commission, which I think has been a very thorough examination of the industry. To give you a sense of the perspective, from our perspective of the scale of that review, we have been through in the context of preparing, responding to the Commission, more than 16 million documents have been analysed and reviewed. We have responded to 167 Notices to Produce, providing more than 220,000 documents to the Commission. We have had almost 70 witness statements, 19 separate submissions, and 16 witnesses have actually appeared.

It was a very critical and insightful report. I think it quite clearly highlighted the failures of our institution and of course of others, which should never have occurred, and we do not underestimate the work that is required to ensure that we are able to restore confidence as I said, and earn the trust of our customers and the broader community. We are already getting on with a number of the recommendations, and we are able to do that. We will continue to work closely with the regulators and of course some of the overall timeframes are ultimately in the hands of the government.

We tried to provide some additional disclosure in this Result, just to give an aggregate on the sorts of provisions that we have made in the past. Again these are of course remediating and refunding our customers with interest for issues that should never have occurred. We tried to provide that disclosure to give some clarity. As you would expect, and has been called out, a number of those issues have related to our Wealth Management business and the broader industry. And I wanted to highlight again what has been and will continue to be our approach, which is as we find any issues, as soon as we are able to reliably estimate them, we provide for them conservatively. As you can see, those provisions that exist as at 31 December, and of course we will continue to work through any issues that we either may discover, or that flow from some of the Commission's recommendations.

As I said I think we are making good progress against a number of divestments which have been announced in the first half. We have completed the Sovereign and TymeDigital divestiture. The sale of our 37.5% stake in BoComm Life. The regulatory approval process for that is taking longer than expected. It is now the only outstanding condition precedent on the sale of our CommInsure Life Insurance business.

Overall on the right hand side of the slide we have again tried to focus our operating model and structure on ensuring that we are having very focused clear business unit leads who are focused obviously on our Retail Bank, our Business, our Institutional Bank, which we remain committed to, but has also been very focused in the half, and you have seen that come through in terms of the risk weighted asset reduction, and improvements in organic capital generation. And then lastly we made a $50 million investment into PEXA, which is what we would see an important part of our overall home buying ecosystem.

As you will have noticed, we put an additional, some disclosure here in the context of how we are thinking about costs. And of course overall we have got to really recognise a couple of important things. Quite rightly both myself and my Leadership Team will be judged on what we are able to deliver. And every period we will be talking about what we have done in the period that has gone before. We have to of course balance that against an elevation in our risk and compliance spend. As I said I think that is entirely appropriate given the current context. But we recognise that we need to make some absolute structural cost reductions to ensure that the organisation is best positioned for the future. That we are right size in the cost base for undoubtedly a more intensive competitive environment. That we are also making the right investments for the long term, and we are able to put real investment into our technology, into our digital and customer experience.

You will see at the right we talk specifically around our cost to income ratio, that is one but an overall imperfect measure. But certainly as we look at our overall structural cost base, we see a number of opportunities over time to really focus on the end to end digitisation, removing variation from the processes, much greater automation. Of course over time there will be the digitisation of some of our distribution costs. It is absolutely critical we are able to reduce the unit cost of technology and change. There is obviously a number of different technologies available to reduce the cost of compute, storage, but ultimately being able to maximise the output for the investment dollars that we are putting in. A much greater focus on just cost discipline throughout the organisation. And of course a simpler operating model, less bureaucracy, faster decisions, better execution.

From a digital perspective, we are very pleased with the way our business is performing there. We have got now more than 6.7 million active digital customers. We have five million daily logons. We have clearly the market leading app, certainly from our perspective. The most satisfied from a customer perspective. Forrester recently rated us the number one mobile banking app in Australia and number three globally.

At the full year results, I talked about the customer engagement engine, which is something that we have invested in over the last few years, which quite simply analyses 30 billion data points in real time and orchestrates all of the contact and conversations that we are having with our customers across 23 channels, so digital, contact centre, branch, email, ATMs.

To give you some perspectives about how we use that to improve both the customer experience and some of the outcomes, over the first six months we have had 10 million face to face conversations that have been orchestrated through our customer engagement engine, more than 130 million in total. We have helped an incremental 10,000 customers complete an application through real time pipeline management. We have orchestrated contact with 100,000 customers who have a maturing term deposit. We have got an 85% renewal rate. We use the customer engagement engine to activate customers after we launched Apple Pay. We have had more than 500,000 registrations in the last fortnight. We now have 1.5 million customers, or cards, registered for mobile banking.

And so importantly we really see that as a way that we are able to demonstrate that we are adding value for our customers as well. We send every month more than 120 million transaction notifications, helping them manage their expenditure. We also every month send 1.5 million notifications telling them when their repayment is due, making sure that they are avoiding, as I said, any unnecessary fees and charges. We have even started using it in the context of third party data helping our customers, for example, when they are eligible for a rebate on their third party policy, and we have started to roll it out across the Business Bank in the last six months as well.

Overall, as I said, I think the result really demonstrates the strength and resilience of the franchise, our cash net profit after tax up 1.7% on the prior corresponding period, 8.3% sequentially. We have seen an improvement in our return on equity of 13.8%. That organic capital generation has enabled us to deliver a very strong capital position [ratio] of 10.8 and we are now 'unquestionably strong', with a $2.00 fully franked dividend, and we have also announced that we will be neutralising the dividend reinvestment plan.

Overall our operating income, we have seen weaker margins offset by a stronger volume growth. We have also had approximately $60 million of impact from the weather or storms in New South Wales and Victoria in the half. I think our operating expense performance there is flooded by two factors. Number one, just a smaller number of one-off reductions in the in-prior period. We have also had $145 million of insurance recoveries which we called out towards the end of last calendar year.

The loan impairment expense remains low, but you will have seen that it has picked up a little in the corporate book which I am sure we will return to, again ultimately delivering a cash net profit after tax of +1.7%.

Our volume growth, from my perspective, has been one of the most pleasing aspects overall. Again much better stabilisation of momentum particularly in our Retail Bank during the half, basically growing at system in home lending. The lending growth of 5% includes New Zealand. And as you would expect with that real focus on capital and risk in our Institutional business we have seen a reduction overall in balances, but we are very comfortable with the risk weighted asset trade-offs that we are making there.

And what has been a highlight of the Group's performance for some time has been our strong transaction growth for the Retail Bank in the half, 14%. We have seen our overall deposit funding move to 69%, which again is a real highlight of the overall result.

Bit of a mixture across each of the businesses. If you look at Retail it is, as I said, a better stabilisation and volume performance slightly above system in both home lending and deposits. Bankwest slightly below in both. That is a consequence of course of a slower geographical exposure for Bankwest in WA.

We have seen net interest margin come down on both the prior corresponding period on 11 basis points sequentially. There has been a combination of factors in there. Of course much higher funding costs and we call out that exposure, net exposure to basis risk premium and a drag on margin from customers switching from interest only into principal and interest. Costs overall I think are well managed and loan impairment expense as well.

Turning to the Business Bank, as I said, I think the deposit growth and transaction performance has been the highlight there. We have been prepared to have a real focus on both capital and pricing and risk, particularly from a property development perspective in our Business Bank. It has seen our balance growth be quite modest from a business lending perspective, but we have seen a stabilisation in our net interest margin over that period.

Again, as I look at the Institutional Bank, really flat net interest income. We have seen a reduction in the performance of our trading and markets division. Overall a very strong, as I said, organic capital generation. And New Zealand once again, a very strong output, good volume growth leading to overall 8% revenue growth.

That finally leads us, as I have covered, a 10.8% common equity Tier 1, a payout ratio of 74%, and leaving us in a position for the first time in four years to be able to neutralise the dividend reinvestment plan. And on that note, I will hand over to Alan.

Presentation from Alan Docherty

Alan DOCHERTY: Thank you, Matt, and good morning. I am going to walk through the Result in some more detail now, but firstly to summarise it. I would say that the top line represented by our revenue growth was weaker versus the comparative period, but the bottom line represented by the risk adjusted profits we generated was exceptionally strong. And both that weaker top line and stronger bottom line were a function of the challenging economic and regulatory context in which we are operating, countered by very disciplined and focused execution of our strategy on better customer outcomes and on risk adjusted shareholder returns.

The economic and competitive context that we are responding to included margin pressures and a softening housing market. And that contributed to a 2% decline in revenue on the same half last year. Risk and compliance costs also remain elevated.

In that context then we were pleased to be able to deliver such strong outcomes across our core businesses, with home loan growth back broadly in line with system, another strong period of transaction deposit growth, and an exceptional level of organic capital generation.

But let me start off as usual with the reconciliation of statutory profits to cash profits from continuing operations. The statutory profit for the half was $4.6 billion. From that we deduct the profits from our discontinued operations which totalled $92 million on the half. That is less than half the amount of discontinued profits that we earned in the prior six-month period and there were three reasons for that.

Firstly, our Australian life insurance business experienced higher claims, particularly in income protection products, and this is consistent with what we have seen across the broader life insurance industry. We have also seen lower premium income due largely to the loss of two large wholesale schemes in the previous financial year.

Secondly, our Global Asset Management business benefited in each of the two prior halves from higher one-off performance fees generated from asset sales. And thirdly, each of the two prior periods included approximately $50 million per half of profit from our New Zealand life insurance business, Sovereign, which we of course sold in early July 2018.

We disclosed the impact on the statutory result of non-cash items during

January, and you can see there the various transaction costs incurred as we continue to simply our business, together with the reversal of unrealised hedging gains due to the depreciation in the Australian dollar.

And so if you deduct all of those items from the statutory profit we arrive at our cash profit from continuing operations of $4.7 billion. And as Matt has described, that profit is 1.7% higher than the prior comparative period, with operating income down 1.9%, offset by a 3% decline in both operating expenses and loan impairments.

So drilling into that operating income decline of 1.9%, you can see very clearly how our revenues are affected by both the challenges of the current context but also our focus on better customer outcomes and our focus on risk adjusted returns. With our net interest income home loan volumes included strong growth in owner occupier balances, and our transaction deposit growth demonstrated again the strength of the franchise and the quality of our digital platforms.

Business lending growth across Australia and New Zealand grew 5%, though as we have said, within that the domestic business and private banking lending growth was 2%. That was due partly to our targeted runoff of apartment development exposures. We continued to run a tighter credit posture on that portfolio, and that obviously hurts our top line revenue momentum, but aligns with our cautious view on that sector and our discipline around earning above hurdle returns. And you can see that same focus continued to come through the reduction in our institutional lending exposures as we continue to right size that portfolio.

The interest margins reduced six basis points on the prior comparative period, that was down four basis points in the last six months. I will unpack that margin decline in the next slide, and it was that margin decline which led to the 1.3% reduction in net interest income. Other banking income fell 4.8% and was due to the reduction or elimination of a number of fees and charges for the benefit of our Retail and Business customers. Other banking income was also impacted by difficult trading conditions and our global markets business. And as Matt mentioned insurance income included $61 million in claims from the damaging storms in New South Wales and Victoria during December.

Looking into that four basis point net interest margin decline, there were really three factors within that decline and we talked about each of these three at the last full year result. Firstly, asset yields contributed three basis points of margin decline that was due to home loan customer switching and increased home loan competition. The benefit of a repricing of standard variable rate home loans in October was offset by more competitive fixed rate home loan pricing and lower consumer finance margins. Secondly, the lower replicating portfolio benefit in the half offset some of the deposit repricing activity that we undertook during the last six months. And thirdly, the elevated level of basis risk cost us two basis points of margin in the half.

Operating expenses were down on the prior comparative period, largely a function of the non-recurrence of those prior period one offs, $145 million professional indemnity insurance recovery on the AUSTRAC civil penalty. And then against that we had the gross-up of expenses due to the consolidation of our mortgage broking businesses with $200 million recognition of an indemnity provision for historical remediation issues relating to our Wealth Management business, and $121 million increase in costs due to the uplift in financial crime compliance, higher customer remediation provisions, and also the costs of our Better Risk Outcomes program which is coordinating Group-wide actions to fix the issues identified by the APRA Prudential Inquiry. Excluding those items, costs were up $76 million, and that was due primarily to $50 million of higher IT amortisation.

Turning to our balance sheet risk settings, we continue to adopt conservative settings across the range of risk types in order to be ready for and responsive to a range of macroeconomic outcomes. On credit risk we continue to be disciplined and selective around our risk appetite to particular sectors, and we continue to hold peer leading provisioning coverage levels. On the liability side of the balance sheet we have continued to increase our net stable funding ratio, up from 110% a year ago, now at 112%, and that was due to strong growth in Retail and Business deposits. On liquidity we have held our coverage ratio well above regulatory minimums, now at 131% over the last quarter. And on capital we have reaped the rewards of that focus on risk adjusted return, achieving our unquestionably strong capital benchmarks 12 months ahead of the regulatory deadline.

So looking firstly at credit risk, our loan impairment expense remains at historical lows as a proportion of our lending exposures, with very low levels of loan loss experienced across both our consumer and our corporate portfolios in Australia and in New Zealand. You can see the Business and Private Banking loan loss ratio increased to 19 basis points, all of that increase related to material downgrades to two clients. We continue to be watchful for signs of a broader deterioration across industries and regions and will continue to monitor that and calibrate a risk appetite accordingly. Troublesome and impaired assets increased although off a low base. In the last six months since June that increase related to a single large institutional impairment in the construction sector and higher home loan impairments.

And looking more closely at consumer credit quality we have seen stable to improving arrears rates across personal loan, credit card and home loan portfolios in the last six months. Although if you look against December 2017 there was an elevated level of arrears over the 12 month period. We believe this continues to reflect the small number of households experiencing difficulties due to rising essential costs and limited income growth. And what that has done is muted the normal level of seasonal improvement that we would see in the first half of our own financial year, and so we would expect in the second half of the year for those arrears rates to trend higher. In that regard we are pleased with our decision at the beginning of the financial year to significantly increase our customer collective provisions upon the adoption of the new loan impairment accounting standard.

On wholesale funding we calibrated the tenure of a new long term debt issuance to ensure that we maintained the weighted average maturity of the long term debt portfolio above five years. We can see on the right hand side of this chart that funding costs have continued to increase over the past six months. If I give you an example, in August we issued five year domestic term debt, it cost 93 basis points over the bill rate. We issued a debt of the same tenure domestically in January, that cost 113 basis points. So that together with the elevated level of basis risk means that funding cost pressures will continue to emerge in the period ahead.

On capital we have had another strong period of capital generation taking our CT1 to 10.8% above the 10.5% unquestionably strong benchmark. The organic capital growth in the period of 66 basis points is really down to three factors. Firstly, that discipline around front book credit origination and also back book portfolio optimisation, has delivered 35 basis points of that increase, net of the dividend payment.

Secondly, we revisited our interest rate risk settings over the half and so two-thirds of that 24 basis point improvement in IRRBB risk weighted assets relates to structural reduction in our interest rate risk, and therefore that will persist into future periods. The remaining third of the IRRBB reduction related to favourable market rate movements in December, so you may see some of that unwind in future periods.

Thirdly, the reduction in market risk weighted assets was related to the implementation of an updated value at risk model. The previous model was given unduly conservative measurement of our underlying market risk exposures.

As we look to the period ahead the decision to neutralise the interim dividend reinvestment plan will mean that the dividend has a higher than normal impact on CT1 in the second half. And again we have broken out that capital generation across each of our operating divisions. Business and private banking delivered particularly strong levels of capital generation despite that slowdown in business lending momentum, and that is testament to the level of discipline in the business around risk adjusted returns. Institutional banking and markets continued to improve their client relationship returns as they continued to reshape and re-weight that portfolio.

In summary then, it has been another challenging period for the Commonwealth Bank but our focus on our customers and our discipline around capital efficient growth are very evident in this half-year result. And with that, I will hand back to Matt.

Further Comments from Matt Comyn

Matt COMYN: Thanks very much Alan. So I thought maybe I would just do two things quickly on the economy and then try and provide some perspectives around housing, and particularly availability of credit. First and foremost we continue to see the Australian economy performing well. We are seeing GDP growth of close to 3%. We are seeing a fall in unemployment, a fall in underemployment. I think there is evidence of capacity constraints and a slight uptick in wage growth. Obviously high commodity prices are helping the overall budget deficit. So overall we feel like the Australian economy continues to perform pretty well.

Of course there has been quite a bit of focus on the housing market and particularly what has been leading to that. And page 79 in the results there, we have tried to give a bit of perspective, particularly dealing with what has happened to borrower capacity. And so almost all of the changes that had a reduction on borrower capacity occurred between 2015 and 2017. I would estimate that that could have had an impact to maximum borrowing capacity of somewhere between 15 and 25%. Obviously that will vary depending on the borrower, depending on their circumstances.

Importantly as I said, that was pre-2017, and the big changes that led to that were increases in income-based HEM, the introduction of minimum floors around interest rates, capping of certain income types, reductions on unstable sources of income. We have seen that sort of translate, obviously in the context of the last six months, actually average loan sizes have been slightly increasing. I think it is really important to note that more than 90% of borrowers do not actually borrow at the maximum. So that 15 to 25% is really affecting the 10%. We have seen our application rates, sorry our approval rates, largely stay unchanged. We have actually, more importantly, seen a reduction from a demand perspective.

Before I talk about demand, then I think it is important to then maybe try and put into context, what is actually happening in 2018. So what you have seen from us and across all of the financial institutions, is a much greater focus on very granular expense verification. Now that has seen us reduce the number of applications that are relying on HEM, otherwise the prudent floor. And what does that feel like from a customer perspective? It feels like there is a lot more rigorous enquiry into the underlying expenditure.

It has a very minimal impact at a borrowing capacity level. We almost have to put that in the context of more than 80% of people who are applying for credit for a housing loan, it would not be their first home loan, and so applying for a loan at the Commonwealth Bank, and I dare say it at others today versus five years ago, it would feel like a more rigorous process. But I do not think that is the causation to, the perception that there is a reduction in the supply of credit.

I think importantly, of course, from a demand side, if you separate between owner occupied, I would say largely application volumes are probably flat over the last two years. Whereas if you look purely at investment lending, we have probably seen a reduction in the order of 25 to 30% of application volumes over the last two years. I think that is entirely appropriate and consistent with the outcomes that you would expect from a number of measures that were put in place by both the regulator and APRA which I think is entirely prudent and appropriate.

We have seen the impact that we would have expected which is a slowing in credit growth. We have seen a slowing in turnover and, of course, a fall in house prices. We also have to put that in the context of a market like Sydney which, of course, for any individual looking at it, the value of their home falling, that is an unpleasant feeling. But in that context, five years ago, you know house prices in Sydney are still 60% higher than they were at that point in time.

Finally I would just focus on the summary of the results from my perspective has been obviously a lot of change in the organisation. Really trying to get to the root cause of issues and failures in the past. A big focus going forward, and actually being able to demonstrate real actions and being prepared to be judged by those actions. For us, part of that of course has to be really focusing on running our businesses really well and the core operating momentum, making the right trade-offs around volume and margin.

We see a continued uptick in funding costs, you see that come through and weigh on our net interest margin in the first half, and that net exposure of $160 billion to basis risk which is currently I think spotting in the high 50s continues to be a drag on margin going forward. But we will continue to be very focused on optimising our business and ensuring we are delivering a strong capital result. And whilst delivering better customer and risk outcomes, increasingly turning to our overall cost base.

On that point I will hand over to Mel for Q&A.

Analyst Q&A

Melanie KIRK: Thank you Matt. We will start with questions in the room and we will wait for the microphone. Please state your name and the organisation that you represent. Please limit your questions to no more than two questions to allow everyone the opportunity to ask questions and we will take the first question from Jarrod Martin.

Jarrod MARTIN: Jarrod Martin from Credit Suisse. Matt, appreciate the additional information on a simpler Bank and cost reduction, but obviously it raises some more questions without some numbers and timeframes et cetera. Look, the cost base, the starting point, that's probably, I think it's reasonable to have an understanding of what is the sort of core cost base that you were referring to? The slide says $11.5 billion in the total but then there is a core underneath it. I think it's reasonable for the market to understand, what do we need to judge you against. So what is that core level?

Then secondly, what sort of investment do you need to make to get some of the reductions? And lot of times with programs, you know we don't see those cost reductions until, "Oh, we've got to spend another $500, another billion dollars here". Is CBA in the situation where the things that you called out in terms of automation and digitisation, there's not a great deal of investment and so they can be effectively started executing from day one?

Matt COMYN: So a couple of elements. Yeah, you are quite right. We tried to strike the right balance, being between giving a better view on at least how we are thinking about the cost base, but also importantly, recognising that we will be judged against our performance each period without necessarily wanting to put too much detail around future targets. I mean when we talk about core and non-core, basically if you back out the divestments that we have already announced, you get a core cost base.

Then to your second point around investment. What we have consistently said to date is we do not foresee a large scale investment that is going to be announced to be required. Of course, some of those productivity and cost reduction will require investment along the time.

We have to make the right trade-offs. Clearly at the moment you see in our disclosures, 64% of our investment is put against regulatory and compliance. That is going to remain elevated. Over time, we would like to be putting more of that investment into both productivity and growth. So clearly, we see the need for incremental rather than large scale CAPEX announcements at this point in time.

Melanie KIRK: We will take the next question from Jon Mott.

Jonathan MOTT: Jon Mott from UBS, and no surprises, I'll keep on going from what Jarrod was on. The 40% cost to income target that you've called out, if you flip to page 16, you're already saying that operating expenses to total income, excluding notable items in prior period one-offs, for continuing operations, so you know, backing everything out, you're already at 39.7. So if you're assuming that your costs are going down, it's a pretty negative outlook for your revenue that you'd be implying.

Given if you look at the first quarter, you had a really strong revenue, and it appears to have really slowed down the second quarter, despite the mortgage repricing kicking in, is it fair to assume from this that any improvements really got to be working hard on costs firstly, and secondly, you're very, very cautious about the revenue outlook in those comments?

Matt COMYN: Well firstly, Jon, that is a very quick calculation, and you are right on the costs side. So from our perspective as we thought about it, and I do not think the timing is right to be putting too much specificity around exactly what our end point is. From our perspective it is a question of how far below 40% cost to income ratio. And I would not necessarily infer that it is a very negative view about income growth. I mean, we of course see what you can, which is falling volume from a credit growth perspective. We certainly have some near term headwinds from margins. And in terms of the presentation and preparation for that, there are obviously a number of outstanding issues that we are starting to work through.

So we have also got to be cognisant of being able to make the right decisions in any particular period, making the right investments for the long term. Ultimately our income performance will largely be constrained by the overall performance of the broader economy. So I would not say that we are more positive or negative about revenue outlook, other than what we have already seen, which you can see in the half, the pressure around margins.

Melanie KIRK: We will take the next question from Andrew Lyons.

Andrew LYONS: Thanks Mel. Andrew Lyons from Goldman Sachs. Matt, in your concluding remarks you highlighted the interesting slides in slide 79 of your presentation, which suggests your maximum borrow has not moved in the last 12 months. Just two questions on that. Firstly based on your initial read of the Final Report of the Royal Commission, are you expecting any movement in that over the next 12, 24 months? But also just based on your current discussions with ASIC and APRA, do you think that there is any incremental pressure on maximum borrow?

And then just a second question, just in light of this. I note that against system mortgage growth of about 4.7% year over year at the moment, the major banks are collectively growing at about 3.3%. Now, I admit you guys are growing a bit quicker than that. But you look at the non-major banks, they’re growing at about 8%, and the non-banks at about 12. Just want to see if you have a view on do you think this is due to the timing of credit tightening, that the major banks have been focused on earlier, or have customers been more inclined to bank away from the majors than what they have traditionally?

Matt COMYN: I think to answer the second part first, I think it’s more about just the timing of some of those, the tightening in the application of those policies. As you quite rightly expect, they tend to start with the major institutions and work their way through the rest of the industry.

In terms of borrower capacity, I mean, I can rely certainly on the public comments today, which is that the heavy lifting is largely done. There is nothing that I can see that really has the capacity to reduce our borrowing capacity, certainly at an individual system level. As I said, I think the main factor which people have seen and are talking about is that there is more granular expense inquiry. That is certainly the case for us. I am sure that will work its way through the rest of the industry. At the margin, the application of that policy can have a slight impact on borrower capacity.

But again putting that in the context of 90% of people are not borrowing at the maximum, I do not think the supply of credit is a big constraint going forward, and I think there will be a stabilisation of some of those conditions. But for an individual borrower, as I said, who is going through an application process today versus five years ago, it would feel like a more rigorous experience. You hear brokers who would say the interview is taking a lot longer to actually complete, to get the information that the bank requires. Again, I think that is a prudent application of the existing responsible lending laws. But I cannot see anything incremental to what we already know today coming in the pipeline.

Melanie KIRK: We will take the next question from Victor.

Victor GERMAN: Thank you, Victor German from Macquarie. A question on capital. Obviously very strong capital position, and mindful of the fact that there are divestments coming through, so on a performer basis you are seeing close to 12%, based on my very quick calculation. So a couple of questions on that. So the first one on replicating the portfolio. You've had a benefit from that coming through it appears in the half. Just if you can, maybe Alan talk us through all the moving parts in terms of what's the new duration for both capital and deposits? And presumably moving to a shorter duration would have a cost to P&L as you move up front, so just an indication of what that is, and whether that's been captured in the half.

And just more broadly on capital, 12%, obviously a very strong capital position.

There's New Zealand uncertainty, but even taking a very conservative approach on that, it seems like you should be well clear of the targeted level, whatever that might be. You're thinking around what you're planning to do is a strategy to maintain the dividend despite your earnings coming down, and increase the payout ratio, or should we be expecting some capital management initiatives in the near to medium term?

Alan DOCHERTY: Yes, thanks Victor. So on the IRRBB reduction firstly. That relates to the invested term of capital, so that is really invested term of our equity balances as opposed to the replicating portfolio, which is the investment term of a non-rate sensitive deposit balances. So the theory is similar, although that particular reduction in interest rate risk settings really reflects a shortening of the invested term of the equity. For many years we have had a longer investment term on our equity balances than other banks, and you have seen through a decade of falling rates that that has a benefit in terms of stability of earnings and lower margin impacts through the rate cycle.

The cost of that comes with a higher interest rate risk in the banking book, and you would have seen higher risk weighted assets in that regard for CBA relative to other banks. So during the period we had a look at interest rates risk settings, given we are at or near the bottom of the rate cycle, we felt it was the right time to bring our invested term of equity back into line with the other banks, and obviously you get a persistent benefit through a structure for reduction in IRRBB. We separately run a replicating portfolio, we have not changed the settings on the replicating portfolio, we continue to be comfortable that it will match the asset profile of the Bank.

In terms of the P&L cost, you would have seen some of that reduction come through in the current half, it is not a material impact given the level of rates at the moment. Secondly around – sorry?

Victor GERMAN: What's the new duration?

Alan DOCHERTY: Our duration is in line with all the rest of the industry, you can see through the IRRBB risk weighted assets. We have not given specific disclosure around the length of that.

Secondly around the capital position, I think as you have said there is a strong pipeline of divestments. You have seen I think a sign of the Board's confidence in our capital outlook with the decision to neutralise the interim dividend reinvestment plan, and we will continue to discuss capital management options with the Board as we move forward.

Melanie KIRK: We will take the next question from Andrew Triggs.

Andrew TRIGGS: Thanks. Andrew Triggs from JP Morgan. Two questions please, firstly just following on the cost side of things. You mentioned the reduced spend on productivity and growth, and some quick calcs suggest that that's annualising at around probably less than $400 million versus around $700 million a few years ago. So just in terms of when the regulatory spend starts to ease off, can you actually see a reduction in overall investment spend, or does it get eaten up in more investment into the other area?

And also just again thanks for the additional guidance on slide 79 around lending standards. Just interested if you could make any comments on whether you've seen the reliance on HEM increase over time? So you mentioned obviously the changes made in previous years, and reduced for maximum borrowing capacity. But have you seen an increase to around that sort of 80% level in 2018, that the reliance on HEM in your borrow costings?

Matt COMYN: Yeah sure. So let's deal with investment spend first, I mean you are quite right, we called out 64% of the investment spend in the half on reg and compliance. It was 50% in the half before that. I think if you went back a few years and you adjusted it, the absolute level of investment is probably about 30%. So a clear elevation. We think that is absolutely appropriate at the moment to ensure that we are able to deliver better risk and compliance outcomes, and better outcomes for our customers overall.

I guess our starting position would not be to be reducing investment spend going forward. Of course we will evaluate that in each period. But we think it is going to be very important that we are able to invest in our business, both in our core customer experience and potentially around our core businesses. We certainly foresee elevated investment in technology, I think that is critical to make those right investments for the long term. In the foreseeable future, I think it is fair to assume that we can expect elevated risk and compliance spend, and over time we would like to see, once we have been able to demonstrate that we are able to operate at a lower risk and deliver those better outcomes. We would like to be able to put more of that investment towards productivity and growth, as you said.

Secondly, your question on HEM. I think for us, and I dare say for the broader industry, I think it was October 2015, the change to HEM, which basically was an income based HEM, so pretty much HEM was increased based on the underlying income, or a shift to that methodology. What you really saw during that period of time, which is logically what you would expect, is a high proportion of borrowers were hitting the prudent floor of HEM, at that particular point in time. We saw that, I guess, stabilise, and I think for us it has been a big focus, I know it has been for others. You have seen a proportion of new loan applications that rely on HEM falling over that period of time. And I think it is fair to assume that that will continue to fall over the next 12 months.

Melanie KIRK: Okay, we will take the next quick question from Richard.

Richard WILES: Good morning, Richard Wiles, Morgan & Stanley. I've got some questions on capital. As Victor rightly points out, your pro forma is at 12%. You have said that the three life insurance sales will complete before the end of June. You have also said that CFS GAM will complete some time in the middle of the year. Today you have flagged your strong capital generation, so if we put all those things together, it is quite possible you are comfortably above 12% at June.

So the question is, why wouldn't you be announcing some significant capital management initiatives? You have got a 5% earnings hold from the asset sales, so if you don't do capital management, your EPS is under pressure. You have also got pressure on your ROE. Today the ROE is under 14%. So I would like to know why you wouldn't be announcing three or four billion, $5 billion of capital management initiatives in the second half of this calendar year. I would also like to know why, if the insurance sale is complete, why you wouldn't consider a special dividend before the end of June?

Matt COMYN: Sure, let me start, and Alan, if there is anything you would like to add, by all means.

So I will start from the top level. So strong finish at common equity Tier 1 of 10.8. Forecast, as you can see in the disclosures, approximately 123 basis points. I think Richard, and as I said at the outset during my presentation, the Chinese regulatory approval process for the sale of BoComm Life is taking longer than expected. That is the only remaining commission precedent on the sale of our domestic life insurance business. We now have all other regulatory approvals processes in place. Our Global Asset Management transaction in which we announced, and we believe, will settle we said in the mid-year. But of course, with a transaction like that, and everything is on track, there are of course regulatory approval processes. You do not tend to make applications to do capital management in advance of actually receiving the proceeds from a regulatory perspective. And then I guess lastly, any capital management initiative decisions are for the Board, and at the appropriate time, if and when we feel that that is in the best interests of shareholders, then that will be a Board decision, and of course we will announce that shortly immediately afterwards.

Richard WILES: So aside from the timing of completion and the Board making a decision, there aren't any other considerations that we should be thinking about? Because you will have four, five, $6 billion in surplus capital, depending on whether you want to be at 10.5 or 11. I mean, if you want to be near 10.5, you are going to have five or $6 billion of surplus. Is it just a timing issue? Is it just contingent on completion?

Matt COMYN: It is contingent on the transactions that have been announced, and of course the Board will make that decision at that point in time, and there is nothing additional I can add at this stage.

Melanie KIRK: We will pass the microphone back to Brian Johnson.

Brian JOHNSON: Brian Johnson, CLSA. I'd just be interested if we could get your view on whether you think the RBNZ are actually softening the capital by extending the consultation period, but releasing the papers that confirm their workings that there is basically a potential hole? And then I was wondering Alan, if you could share some details with us about the exit run rate on the NIM that you are seeing right now? Because, during the period, we only had basically three months of the housing repricing come through, we had that big switching on the fixed. Could you just run us through where the end rate NIM is right now?

Matt COMYN: So I will add some perspective on both and Alan, you add. First though I would not like to speculate about the views of the regulator. As you said, the consultation period has been extended. We will engage extensively during that period. Clearly what has been announced is a significant increase in capital. We do see the potential for that, not only to affect shareholder returns, but also the availability and price of credit in New Zealand. I am sure that that will be carefully considered in any potential impact on important parts of the New Zealand economy.

We will not give specific disclosure on exit NIM. I guess there are a couple of things to think about in the context of forward periods. As you said Brian, we do not get the full benefit of the 15 basis points repriced on standard variable rates. That is clearly a tailwind. The headwinds, of course, are about $160 billion of exposures to basis risk premium, and what is happening with funding costs. As Alan called out, some of the headwinds on an asset pricing perspective, you have got switching of customers from interest only into principal and interest. You have got a high proportion of customers that switched to fixed in that period. We also saw there is a drag on NIM and consumer finance, it was actually a lower revolve rate. So I think you have got to offset, and as you would expect, a lot of competition for new housing in the current competitive context, but also in a falling system growth environment. So I am not answering your question directly, but there are a number of headwinds, and of course you have got to factor in the tailwind of that repricing benefit.

MODERATOR: We will take the next question from Matthew Wilson.

Matthew WILSON: G'day, good morning, Matt Wilson from Deutsche Bank. Just two questions if I may? You claim leadership in digital banking. Open banking starts in July. I thought you would have been more excited by the opportunity that that presented, and we would have a slide on it today. Can you add some colour to what open banking means to you?

And then secondly, to flesh out further Andrew Lyons' question on slide 31. Those five reasons don't really gel. It seems more of a political narrative that has come over the bank sector in the last week or so. You're following on from Brian's comments, you know, 'we're open, there's a supply of credit'. That would seem to imply that your borrowers are more prudent than the banks at the moment. You've got a new Chief Risk Officer who has just put his feet under the desk and come from another bank. Can you add some colour, because that slide doesn't quite reconcile?

Matt COMYN: Sure, let me take both of those in order. So you are quite right Matt, open banking presumably will be legislated, and we can anticipate going through a pilot period, and then eventually being rolled out more broadly across a number of our products. I saw your note. I have spent time with the UK banks, I was there in November just understanding their experience. I suspect it may be the same here, which is initially I think the take up will be very modest, but in the long term, we think about it not necessarily in the context of defensively, but also offensively. I do think some of the core assets that we have got are really important in that context.

So, the advantage of having such a large customer base allowing to engage them with actively and make those experiences personalised and relevant, I think is hugely beneficial. So, there is a combination of assets which we think are really important to be able to compete in that sort of era. And that of course, is five million logons each day with our customers being able to have very targeted offers and pricing, depending on the product and also incorporating risks. So, from our perspective, it is yes there is a compliance element to being able to deliver on our open banking commitments, but most importantly, actually how do we best get ready to prosper and thrive in that competitive context. And that is critical focus for us and that is one element of it.

Secondly, look, you know, I acknowledge your point, and I understand that it does not reconcile with, and I read the same commentary that you do from others, and I have attempted to reconcile by speaking to lots of different people, but also just looking at the facts. And, the facts are that the changes that were made to policy that had an impact on borrowing capacity were done in 2015 to 2017. The facts are that our approval rates are unchanged over the last 12 months. Our time to get a decision is the same, if not slightly better, that is one the application actually goes in.

We have seen average loan sizes go up, and we publish those. And so then it comes to well how do you reconcile this broader perception? And the only thing I think is the cause of that is undoubtedly the application process for a customer that is sitting down with a lender. When you are being asked to go through 11 individual expense fields, we automate as much as we can within our proprietary lending network, but there is a lot of prompts for our lenders, and so there is a much more rigorous process around individual elements of expenditure.

I think you put out elements like comprehensive credit reporting, which has come online. And so a good example that I heard, a customer that had forgotten that they had taken out a store credit card with a grocery chain five years ago to get a discount on their groceries, that gets picked up. And of course that has a de minimis effect on borrowing capacity, but that is something that is different. And I think if you do that delta between a customer today versus five years ago, I think that experience is different. And I think that process and the time that is being taken, I think that has been confused with a very sharp reduction in borrower capacity. So it is certainly not my intent to just create a political narrative. I actually think the narrative aligns very strongly with the facts. But I certainly accept that that narrative has been told differently by different stakeholders and that is why I wanted to include it in the presentation today.

Melanie KIRK: Great. We will take the next question from Brett.

Brett LE MESURIER: Thanks. Brett Le Mesurier from Shaw & Partners. A couple of questions. You said your home loan growth was increasing, you are up to 90% of system, but that is substantially due to your increased use of brokers, isn’t it? The broker percentage has increased from about 40% to 45% on new business over the past year, so why do you think you are unable to get back to system growth, notwithstanding the increased use of brokers that you are making? And then secondly, on the remediation and program costs of $1.5 billion, you said that is expenses and provisions. Could you tell us how much of that is actually provisions? And can you give us an idea of how far through the process you think you actually are at now?

Matt COMYN: Let me go back to provisions. So let's deal with home lending performance. So if you go back to the second half of last year, and I think to the question earlier, all of the major banks I think have struggled to grow at system. For us, it has been a focus to get much closer to system. I think we have talked about why I think some of the reasons why the major banks have struggled.

Look, I guess I separate the performance and you are quite right insofar as the increased proportion of new loans through the broker channel has increased during that period. I would say at a macro level you have got 59% of applications at a system level are going through the broker channel. I do think the last six months that context has been conducive to brokers, because there has been a lot of discussion and information out there about availability of credit. You see that directly from customers who talk about should they go to another bank when they are asked lots of questions. I mean, at a structural, well, at a system level, I think we have seen an increase.

I guess I would breakdown both flow and stock of our home lending business as follows. And in proprietary, I think fundings are basically flat on the period. We are actually growing above system in proprietary, but there is lower run-off so there has been better retention. And for the reasons that I outlined, slightly higher fundings performance in the broker channel, which is us participating in the broker channel perhaps more so than we have in other periods, and we acknowledge that. So secondly, I am going to hand to Alan looking for specific breakdown on what proportion that is.

Brett LE MESURIER: If you have $1.5 billion and you say that relates to expenses and provisions, so what proportion of that relates to provisions and then also how far do you really think you are through this process?

Alan DOCHERTY: I mean, for that disclosure, you can see on slide nine, there has been some long dated issues that we have been dealing with for a number of years. So the vast majority of that cumulative amount has been spent and the customers remediated or the program costs executed upon. In our full year disclosures, you can see in the provisions note there that there was a breakdown of the outstanding provisions across the various categories, and so there is an element of provisioning within that one full sec. So you will see that again in the full provision disclosures in the annual report. But the vast majority have been taken through expenses.

Brett LE MESURIER: And how far do you think you are through the process?

Matt COMYN: Of the things that we are able to reliably estimate or other elements that we may not be able to reliably estimate for that?

Brett LE MESURIER: The latter.

Matt COMYN: Well I guess as per that characterisation, Brett, it is very hard to say. And the important point from my perspective is to the extent that there is anything that we need to remediate or fix, we will get to the root cause of that issue as quickly as we possibly can. We are going to be focused on refunding our customers as quickly as we can. And the moment we feel that we are in a position to be able to reliably estimate, we will.

Brett LE MESURIER: Just linking those two together then, to what extent do you think the customer remediation problems relate to your inability to grow anywhere near system in home lending?

Matt COMYN: I do not think they relate at all.

Melanie KIRK: We will take the next question from James Ellis.

James ELLIS: Thank you, so James Ellis from Bank of America and Merrill Lynch. Just a couple of questions on loan growth. So the institutional book, which saw some optimisation in the period, and then the business book, where there was a run-off of the development portfolio, I was just wondering in both of those whether that had run its course or whether there is still a way to go there?

Matt COMYN: Let's deal with institutional first. I mean, clearly, the focus on capital and risk, that will continue. We have seen good risk weighted assets reduction of about seven, just under $7 billion over the period. And that is a continuation of what we have been doing for the last couple of periods. That will continue to be a focus going forward. Obviously, the rate of that reduction in risk weighted assets may not continue as it has today. We remain committed to the Institutional business and to supporting our clients, but we want to make sure that we are pricing appropriately for that and earning a reasonable rate of return on capital deployed.

From a Business Banking perspective, look, we funded, I think, $13 billion during the half. As Alan said, we are very comfortable with the decisions that we are making around pricing as well as risk, and particularly in the property development perspective. We have been comfortable to tighten risk settings in previous periods and we have seen a reduction in balances during that period, which, of course, has constrained our ability to grow balances.

Melanie KIRK: We are going to take the next question from the phone. We are going to take questions from Brendon at Citigroup.

Brendon SPROULES: Hi, it's Brendon Sproules from Citigroup. I just have a question on the NewCo that you are planning to demerge later in the year. Can you give us an update on the timetable, particularly does the enforceable undertaking announcement that you made on Monday impact that, or is there anything contained in the Royal Commission Final Report that would impact that demerger? And the second part of that question is to what extent are financial planners within that business incentivised now to maybe find somewhere else, given that you are having to work through this enforceable undertaking?

Matt COMYN: So in the context of NewCo we announced that we would be demerging we said late this calendar year. I do not have any further update on that position. We have appointed a new CEO, Jason Yetton, into that NewCo business. I think we are making good progress on the transition and separation. Of course, in the context of the Royal Commission, we are carefully considering those recommendations and we are going to make sure that we set that business up for success.

In the context of financial planning, look, there is a number of reforms that we had already committed to in the context of grandfathered commissions, moving to a one year opt-in on an ongoing service fee, et cetera. That is not unique to us, but we are certainly prepared to move ahead of the industry in a number of key areas. I think that is really important. But I know Jason will be very focused on engaging closely with our people and making sure again that we are setting up those business for success in the future.

Melanie KIRK: We will take one more question from the phone. So we will take a question for Azib at Morgans.

Azib KHAN: Thank you, Mel. A couple of questions from me. Firstly, on your deposit mix and, secondly, on home loan distribution. So on deposit mix, there has been pretty significant growth in your mortgage offset balances from the June half to the December half, or I should say, from June to December. It has gone up from $42 billion to $46 billion. And it looks like that is what is driving the bulk of your transaction deposit growth over that period.

At the same time you've experienced a decline in your savings balances, which is presumably partly a result of the lower online savings rates on offer you have repriced recently. So just connecting these points together it looks like that maybe there has been money shifting out of online savings accounts and into mortgage offset balances. Is this what's going on and if that's the case, aren't you better off offering slightly better online savings rates? I'll wait for the answer to that and then I'll ask my next question.

Matt COMYN: So I think it is a fair hypothesis bringing a few of those things together. We certainly made some pricing changes on our savings portfolio. Of course we are trying to optimise across the broader portfolio. Transaction banking is a big priority for us in the context of both new customer accounts as well as balances within those accounts. We have seen a continued growth in offsets that is new or unique in this particular period. But ultimately our primary focus is on making sure we have the best everyday banking experience. We are the leader in transaction banking, and across the deposit portfolio, the highlight being 69% deposit funded, and then we are prepared to make volume margin trade-offs in any particular period.

QUESTION: Just as a follow up on that before I ask my next one. So, do you think the online savings rates that you are offering at the moment are sustainable or do they need to go up a bit?

Matt COMYN: Well, as you would appreciate, I will not speculate on any future pricing changes. We look very carefully at all of our pricing in market on a daily basis and we review and make decisions where necessary.

QUESTION: Okay. And next question is on home loan distribution. So Matt, look you've clearly carried out some extensive analysis in relation to broker rem and the cost of home loan distribution which you were asked about in round seven of the public hearings. So presumably you would have a pretty good idea of what it costs you, as in CBA, on average to sell a home loan through the branch channel. Can you please give us an idea of what this cost is?

Matt COMYN: Look, I will not break down the distribution cost differentials between the branch network and the mortgage broking market. I note that over the years a number of analysts have estimated it, and I think that at least some of the estimates that I have seen are quite reliable. As you noted, I was extensively examined on my views in relation to the mortgage broking channel. I think they provide an essential service for customers. But my view as examined aligns with the Commission's recommendations. That was my view then and it remains my view today.

Melanie KIRK: We are going to have to draw the conference call and questions to a close there. So thank you everyone for joining us today. If you have any follow-up questions, please come back to us in the IR Team and we will facilitate those answers. Thank you.

END OF TRANSCRIPT