COMMONWEALTH BANK OF AUSTRALIA

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FOR THE FULL YEAR ENDED 30 JUNE 2019

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Introduction

Melanie KIRK: Hello and welcome to the Commonwealth Bank of Australia's Results Briefing for the full year ended 30 June 2019. I am Melanie Kirk and I am Head of Investor Relations. Thank you for joining us for this briefing. We will be having presentations from our CEO Matt Comyn giving a business update. Our CFO Alan Docherty will provide details on the financial results, and Matt will provide an outlook and summary. This will be followed by the opportunity for a questions and answer session. I will now hand over to Matt. Thank you Matt.

Presentation from Matt Comyn

Matt COMYN: Thank you very much Mel. Good morning all. This year we have been focused on the disciplined execution of our strategy. I feel like we have made very good progress on simplifying both our operating model and our portfolio. And we have been very focused on making sure that we are making the necessary changes to both our culture, fixing and addressing issues from the past, as well as improving better customer outcomes. We have also strengthened our overall digital leadership position, and we have a strong pipeline of new innovations coming to market.

We have a very high quality franchise but it is also one that requires investment, given issues and legacy of the past as well as increasing competitive intensity and increasing regulation. We will continue to do whatever is necessary to invest in our business strengthen our long term health and franchise and make sure that we earn the trust of both our customers, businesses and the country.

Against the subdued operating environment and with increased provisions as well as operating expenses our Result and our cash profit is down 4.7% for the period. Overall our core franchises continue to perform extremely well. Our transaction accounts and home lending performance, two particular highlights. And overall the Final Year Result and our overall balance sheet strength of the Common Equity Tier 1 of 10.7% has enabled us to pay a $4.31 final year dividend. We will also announce that we will be neutralising the dividend reinvestment plan.

Before I return back to the Result I did want to spend a little bit of time talking about some of the ways that we have been strengthening our business. As I said we are making good progress on simplifying our portfolio. Earlier this year we completed the sale of both our Sovereign life insurance business as well as our South African business, Tyme. In June we announced the sale of Count to CountPlus which will now complete in October. This morning we also announced the assisted closure of Financial Wisdom. Last Friday we settled the sale of our divestment of our Global Asset Management business which was at 19.4 times earnings, which increased in a 68 basis point increase in our Common Equity Tier 1.

In our ASX release we also provided an update on our sale of CMLA or our CommInsure life insurance business. As I have said previously the sale of our stake in BoComm Life is the final outstanding condition precedent to enable that sale. Both CBA and AIA are fully committed to making sure that transaction completes. We are well progressed in alternative transaction arrangements should the transfer of that BoComm Life stake take longer. And we believe we will be in a very strong position to be able to update the market before the end of our first quarter. We also remain committed to exiting as we have previously announced our CFS business as well as mortgage broking over time.

Overall as I said our Common Equity Tier 1 finished at 10.7% and ‘unquestionably strong’. We have a very strong pipeline of capital coming through from those divestments. Our cost to income ratio at 46.2%, clearly disappointing in the context of a subdued operating income environment. We believe we have made the necessary choices and investments and focus during a given period. But we also recognise going forward that we absolutely need to be able to reduce our structural cost base over the medium term to ensure that we get to a sub-40% cost to income ratio, which we believe will be important to ensure that we remain competitive over the long term.

As part of those investments we have seen our overall investment spend tick up to $1.4 billion. 64% of that is in risk and compliance projects such as comprehensive credit reporting, open banking, Code of Banking Practice, but again we have been prepared to continue to invest in our overall business.

We are also making very good progress on becoming a better Bank. Over the course of the year predominantly in our Q3 result we have raised $996 million of customer remediation provisions. We have more than 400 people working full time on refunding our customers as quickly as possible. We have refunded $166 million during the course of the financial year, and we want to complete at least another $100 million back to our customers before the end of the calendar year.

We also talked in our Q3 result about the proactive steps that we have been taking to ensure that we are delivering improved outcomes for our customers. This is a range of other changes to fees, investments in making sure that we are alerting our customers, being very transparent, and also removing some of the products that we have previously provided. That has resulted in a $275 million reduction in our income in FY19, and consistent with our guidance that we provided in the Q3 result that will grow to $415 million in FY20.

We are also making very good progress on the Remedial Action Plan, which is our response to the Prudential Inquiry from May last year. Against those recommendations there is approximately 156 milestones, we have now completed 75 of those, so broadly we are on track, and we remain very focused on making sure that we complete that program as quickly as possible.

We have also got work underway to ensure that we are implementing the recommendations from the Royal Commission as swiftly as possible. We have already completed six of those recommendations. We will have completed another eight by the end of December, and we believe we will be able to close out all 23 of those Royal Commission recommendations by 30 June this year.

Last year in September I wrote out to 14 million of our customers and received more than 14,000 responses about suggestions and feedback about some of the things that we could be doing differently and better to serve our customers. Since January this year we are committed to making sure that we delivered at least one customer benefit every year as part of our overall 'Better for You' program. Some of those are more significant in the context of bringing Apple Pay to market, which was the most frequently requested item. A number of the others have actually been incrementally small that we hope have a cumulatively large effect for our customers.

A couple of brief examples. One would be the ability for our customers to have to book a home loan appointment online. It is very small but also important for our customers, as well as enabling us to run our business more efficiently. And secondly as part of our purpose of improving financial wellbeing we have brought a number of innovations to market including our emergency savings tool.

We have also in recent weeks brought more innovation particularly to our digital application, our CommBank app, to market. We now have more than 5.6 million customers using our mobile app. Two weeks ago we launched the CommSec Pocket app, which enables simple and affordable investing with investments from as little as $50.00, brokerage from as little as $2.00 for investment, up to $1,000.00. And we saw more than $1 million flow in terms of investments over a very short period of time.

We also rolled out a small feature to notify our customers when their tax refund was received into their account, and also some simple steps that they can be taking in terms of how they would like to use that tax refund. In the coming weeks we will roll out our CommBank Rewards program, which will enable our customers to receive cash back offers from participating merchants inside our mobile app. This morning we also announced that we had entered into an exclusive partnership with Klarna, a globally leading payments provider, and we are excited about some of the innovation that we will be able to bring to market. We will be able to provide a more fulsome update about that later in the year.

Our investment in our digital mobile app is really starting to deliver very strong benefits both in terms of satisfaction as well as just engagement with our mobile app. More than 5.6 million logins per day. We have recently rolled out a new look and feel to the overall mobile app. But really what is sitting underneath that is a much more relevant and personalised experience for all of our customers. We have enabled and seen some of the most positive features in particular by us being able to link benefits and entitlements as an example that customers did not know that they were able to receive. We have found about 270 different initiatives where we believe we can deliver $150 million of benefits to our customers each and every year going forward.

What of course makes that possible is the investments that we have been making for some time now in our Customer Engagement Engine. Our Customer Engagement Engine effectively in real time analyses more than 150 billion data points. We are using more than 200 machine learning models, and we analysed 600 million customer interactions during the course of the year, to in financial year 2019 deliver 3.6 billion personalised interactions, a lot of those within the app. We are going to continue to make those investments to make a more relevant and smarter experience for all of our customers, as well as of course continuing to make sure that our customers' data and their overall security is at the forefront of our minds. So by making our banking simpler, smarter and more secure, we are able to extend that leadership position.

And what I believe now is really unrivalled in the context of the domestic market, we have more than seven million active digital customers, about 7.5 million daily logons between our mobile app and particularly our Netbank platform. We now have 63% of our total transactions going through our digital channels. And in addition to a very strong Net Promoter Score which has been in place now for many years, we have recently been recognised as the number one mobile banking app in both Australia, the Asia Pacific, and number three app globally.

Turning now to the Result. As I stated earlier that cash net profit after tax is $8.5 billion, it is down 4.7% on the full year period. Our return on equity is 12.5%. We have a full year Common Equity Tier 1 of 10.7%, up 60 basis points. But as I said that excludes the 68 basis points of Common Equity Tier 1 from the sale of our Global Asset Management business, and our full year dividend of $4.31, and again we will be neutralising the dividend reinvestment plan.

Overall our operating income down 2%, impacted by a number of factors including a five basis point reduction in our net interest margin over the course of the year, although our net interest margin was flat sequentially. There is also $117 million of weather events included within that, and the fee changes that we call out here are referring specifically to what I discussed earlier around the better customer outcomes.

In the context of our overall expenses, including both remediation, increased investment and operational risk and compliance, our overall operating expenses are 2.5% up on prior year. Our loan impairment expense at 16 basis points remains very low. Pleasingly we have seen an improvement in our 90 day home loan arrears, down 2 basis points. We have seen our credit card 90 day arrears down one basis point. On the other side we have seen our personal loan arrears rates still remain high. We have seen an uptick in our corporate troublesome and impaired assets, but our loan impairment expense in

Institutional Bank is extremely low, overall again delivering that cash net profit after tax.

Lending volumes up 2% to $760 billion. Our Group deposits are similarly up 2% to $635 [billion]. I guess the two highlights for some time, first of all our transaction account balances, another very strong year of 9% increase in those transaction balances, now enabling our funding to be 69% funded by our customer deposits. And as I said earlier, a real highlight given our above system lending growth in home lending.

Turning now to each of the business units. The Retail Bank has been particularly impacted by compression on its net interest margin, down 17 basis points for the full year. A big proportion of that, about 14 basis points, impact on that increase in the bills cash spread, which we refer to as basis risk premium, given the big net exposure to basis risk in the Retail Bank. As I said I think the operational execution has been very strong in the Retail Bank, another very good year of transaction accounts, up 9%. I think our market leading turnaround time and speed to decision has enabled us to grow above system during the period.

Our Business Bank, a much better commercial lending momentum I called that out at the first half. We have seen a better performance in the second half, up 5% in terms of spot balance growth. And in our Institutional Bank we have continued to focus on disciplined execution and focus on risk adjusted returns. We have generated $2 billion dollars of organic capital generation from our Institutional Bank, a very strong transaction account performance, and as I said a very low loan impairment expense as well. In New Zealand another very strong year, 5% volume growth enabling a 5% growth in their profits.

Again we are in a very strong capital position as we stand here today, with a pipeline of divestments which gives us a pro forma capital of 11.8%, and that $4.31 full year dividend is 88% above our payout ratio. But if you exclude the notables, brings it back down to 80%. And on that point I am going to hand over to Alan who is going to walk through the Result in more detail.

Presentation from Alan Docherty

Alan DOCHERTY: Thank you Matt. And good morning. I will walk through and unpack the Financial Results for the year in some more detail. But in summary we are intending to focus on staying disciplined in the execution of our strategy, in order to respond to our current context, and keep on delivering strong and sustainable outcomes for our shareholders.

Our continued focus on strategic discipline is evident, and our focus on continued better customer outcomes, careful calibration of our risk appetite, and continued discipline in our approach to balance sheet settings and risk adjusted returns.

Our current context presents some challenges, and we are running the business in a thoughtful and responsive way to meet those challenges, including working as quickly as we can through customer remediation, adapting to the lower interest rate environment, and a start made on simplifying our business in order to reduce operational risks, reduce costs, and create additional investment capacity.

Our continued focus on delivering strong outcomes across core businesses over the long term means that despite near term earnings headwinds, we continue to see excellent operational performance within the Retail franchise, strong transaction deposit growth across all banking businesses, a very strong surplus capital position, and a stable dividend.

Let me start off as usual with the reconciliation of statutory profits to cash profits from continuing operations. Statutory profits for the year were $8.6 billion, from that we take off the cash profits from discontinued operations of $214 million, which are down on the prior financial year due to lower earnings in both CommInsure Life and the Global Asset Management business, as well as the divestment of our New Zealand life insurance business, Sovereign, in early July

2018.

We then deduct the usual non-cash items relating to our business divestments and hedging volatility, and arrive at our cash profit from continuing operations of $8.5 billion for the year. And as Matt has described, that cash profit is 5% lower, with operating income down 2%, expenses up 2.5%, and loan impairments up 11%. Drilling into that operating income decline, you can see that revenue was impacted by margin headwinds, our continued discipline around risk appetite and risk adjusted return, and our focus on better customer outcomes.

Within net interest income, home loan volumes outpaced system growth, our transaction deposit growth continued to reflect the strength of our franchise and the quality of our digital platforms. Business lending across Australia and New Zealand grew 4%, and we continued to adopt a disciplined approach to portfolio risk and return trade-offs across both Business and Institutional Banking, and you can see that reflected in the continued reduction in Institutional lending exposures.

Net interest margins reduced five basis points over the year, they were flat in the past six months, and it was that margin decline which drove the 1.2% reduction in net interest income. Other banking income fell 3.9% due largely to customer fee removals, and the reclassification of institutional lending fees from other banking income to net interest income under AASB 15. And funds and insurance income was lower with impact of severe weather events across New South Wales, Victoria and Queensland, and lower financial advice fees.

Unpacking that stable margin performance over the past six months, you can see there were a number of offsetting movements. Firstly asset margins improved one basis point, with home loan margins stable, an improved lending mix due to reduced lower margin institutional lending and strong home loan growth. Term deposit margins were impacted by lower swap rates, driving that one basis point decline in deposit margins. Portfolio mix improved by one basis point, as we were able to fund more of our asset growth through customer deposits and retire some wholesale funding. And the impact of the lower interest rate environment pushed earnings on free equity down by one basis point.

Looking ahead there are two specific headwinds on net interest margin to be mindful of. Firstly under the new leasing standard, AASB 16, we must recognise a new interest expense from 1 July 2019, costing one basis point. Secondly the impact of the two recent cash rate cuts are forecast to impact on net interest margin in FY20 by approximately four basis points, and that is net of the replicating portfolio and equity hedging benefits and the recent home loan repricing.

Operating expenses increased 2.5% over the year on a headline basis. You can see in the first two bars the impact of notable items, including penalties and customer remediation costs, were roughly the same this year and last. Excluding those items costs were up 2.4% in the year. We were disappointed with that outcome in the context of a declining revenue environment, and it was a function of the good work that we have begun on business simplification being more than offset by costly but necessary enhancements to our risk capabilities and higher staff and IT costs. We now have approximately 2,800 permanent risk and compliance staff embedded across all Line 1 and Line 2 teams across the Group. That is an increase of approximately 600 on last year, and excludes those working on major compliance and remediation programs.

On business simplification we have realised $190 million of cost savings in the year, and that is a combination of in-year savings from the rationalisation of businesses within the international financial services division, reduced physical distribution footprints across both Bankwest and CBA brands, and the simplification of operating models and better cost disciplines across the Group.

As we look forward, our strategic focus on medium to long term cost reduction as we make the Bank simpler remains a key priority for us, and we will continue to hold ourselves and the team accountable for delivering against that priority.

Turning to our balance sheet settings, we continue to adopt conservative settings across the range of balance sheet risk types in order to be prepared for a range of possible macroeconomic outcomes. On credit risk we remain disciplined and selective in our risk appetite, and have retained peer leading provision coverage.

On the liability side of the balance sheet, we continue to widen the gap to peers on household deposit balances, and we have maintained our net stable funding ratio at 112%.

On liquidity we have held our coverage ratio well above regulatory minimums at 132% for the past quarter, and on capital we have remained above the 'unquestionably strong' capital benchmark, absorbing the neutralisation of the interim dividend reinvestment plan, and higher remediation costs.

Looking firstly at credit risk, our loan impairment expense remains at very low levels as a proportion of lending exposures, with both consumer and corporate loan loss rates at the low end of historical ranges, supported by low interest rates and continued low levels of unemployment. Our loan loss rates at our business unit level continued to reflect very similar themes to those we disclosed at the Half Year Result, with Retail Banking loan losses relatively stable, Business Banking loan losses increasing to 21 basis points due to our small number of single name impairments, and Institutional Banking loan losses extremely low due to a combination of portfolio optimisation in the absence of any large single name losses this year.

Troublesome corporate assets increased from $3.1 billion at the half to $4.2 billion at 30 June. Of that increase, around 60% related to downgrades of single name exposures, with the remaining 40% a function of emerging signs of weakness within corporate sectors exposed to discretionary consumer spending, drought affected agriculture, and the construction sector.

Looking more closely at consumer credit quality, we have seen the expected seasonal increase in both unsecured personal loan and credit card arrears rates, although pleasingly credit card arrears were slightly lower now than they were this time last year.

Our home loan arrears performance was also pleasing, declining two basis points to 68 points in the year. We are still seeing signs of pockets of consumer stress, due to the limited wage growth and rising essential costs, however that was offset in the period by improved arrears performance across Western Australia and Queensland.

While we are pleased with consumer credit quality, we remain cautious given the softer economic outlook, and have continued to increase our collective provision coverage, now at 105 basis points of credit risk weighted assets.

On wholesale funding we continue to calibrate the tenure of our new long term debt issuance in order to maintain the weighted average maturity of our portfolio above five years. If you look at the chart on the right hand side you can see that funding spreads have fallen significantly over the past six months. That reflects what we have seen globally with historically low interest rate expectations, historically low corporate and government bonds yields, and tighter bank funding spreads.

On capital we have absorbed approximately $1 billion of new customer remediation and other notable items, and the neutralisation of the interim DRP, and maintained our CET1 above the ‘unquestionably strong’ capital benchmark, spotting at 10.7% at the end of June.

Organic capital generation, excluding the DRP, was above historical averages despite those additional customer remediation costs, reflecting continued strong capital disciplines across the Group. And as we look forward, a number of areas of regulatory capital uncertainty have been clarified recently, and as we look ahead to the completion of our announced divestments, we can expect to achieve a significant capital surplus during the next financial year. As such we were pleased to be able to maintain the full year dividend at $4.31 per share, and neutralise the final dividend DRP.

Our strong capital position creates flexibility for the Board, and its ongoing consideration of capital management initiatives, and the delivery of strong and sustainable dividends into the future. With that, I will hand back to Matt for the outlook and a closing summary, thank you.

Outlook and Closing Summary from Matt Comyn

Matt COMYN: Thanks very much Alan. Just a couple of thoughts on the economic outlook going forward. Clearly we have seen some softening conditions. We have still got a 2.5% GDP growth number into next year. The recent escalation of the trade war is a clear downside risk to global growth. But perhaps countering that on the slightly more positive side domestically we are starting to see the housing market stabilise and improve.

We have seen through a variety of different sources, including our housing intention survey, some work that we do combining our payments data with Google searches, and we can see that the interest level has picked up over the last couple of months. We have seen increased turnover of stock, improved auction clearance rates, and also just seen a stabilisation in terms of credit.

I think in June and July in both Sydney and Melbourne we have had now two back to back increases in each of those months with a slight increase in house prices. For the first time I think since July 2017 we have seen that, with a slight improvement in house prices in Brisbane. And in the overall context we see for us credit growth is 3.7% versus 3.5%. As we look forward, we are probably expecting in that range of 3.5% to 4.5%. We do have another rate cut forecast from our economics team in November. If we were to see credit growth get beyond that range, that would concern us.

We do believe that unemployment at 5.2% already low, but a lot of focus on making sure that the unemployment remains low is overall a real positive. We are yet to see the full effects of the stimulus that has come through from the recent tax cuts, of course the two cash rate reductions, and a lot of focus on the structural underpinnings from investments in infrastructure. An ongoing and long term trend of good population growth which has clearly benefited Australia for many years, and yesterday we saw the impact of high commodity prices, particularly iron ore, very strong LNG export volumes, very strong trade surplus resulting for that, which is further strengthening the overall fiscal position.

But as we look forward, consistent with many commentators, we are really looking at overall consumer and business sentiment, and seeing how that might start to translate into household income growth, which has of course been very modest in recent times.

So briefly in summary before we turn over to questions, we believe the core franchise is continuing to operate and perform extremely well, albeit in an more challenging environment. Really from our perspective that is based around some very strong foundations in our structurally-advantaged customer franchise, our digital leadership, further strengthening of our balance sheet. We remain very focused on ensuring that we are building trusted and deep relationships with all of our customers, making sure that we are earning the trust of both our customers and the community more broadly, as demonstrated through our own actions.

We also recognise that we need to do more on costs, in recognition of our lower income environment. But we believe we have made the right choices to make sure that we are focused in the right areas, and further strengthening our business. The $190 million that Alan talked about in terms of real costs out, that compares very favourably with prior years' performance, but the reality is in a softer income environment we have to do more work and we will on costs in future periods. Overall we intend to continue to invest in for the long term into the areas which bring real advantage, and continue to strengthen the overall health. Thanks very much, and I look forward to your questions.

Q&A

Melanie KIRK: Great, thank you Matt. For this briefing we will be taking questions from analysts and investors. We will be starting in the room and moving to the phones. To ensure everyone can hear you, please wait for the microphone, state your name and the organisation you represent, and to allow everyone the opportunity to ask questions, please limit them to two questions. We will now start with Jon Mott.

Jon MOTT: Thanks Mel. Just two quick questions if I could. The first one, you called out a lot of the headwinds for NIM, but you didn't call out a tailwind, which is kind of unusual. The BBSW has come in very sharply, I think it averaged 41 basis points through last calendar year, and I think today it is around 11. Previously you called out that every five basis points that that moves is one bip to NIM. So give or take it's five to six bip tailwind that you should be seeing if these rates stay at this current level. So I just wanted to double check, is that included in the comments that you've made?

And I'll keep on my second question. If you look at the strong growth in mortgages, it's really being driven by broker. You're up to 48% of flow in this half came through the broker channel. And if you look at the numbers, it means that of the new sales, your proprietary sales in this half were down by 18%, but your broker sales were up by 15%. I just wanted to get a feel, given the comments that you made very publicly in the Royal Commission, Matt, about the broker channel. What happened to turn the broker flow around so quickly, and so substantially? And are you comfortable with almost half of your loans now being written via the broker channel, given your comments at the Royal Commission?

Matt COMYN: Yes, thanks very much Jon. Let me deal with the first part. I mean, your maths is broadly right, in FY18 the basis risk premium was 28 basis points, in FY19 it was 48, so there's a 20 basis point headwind that we saw. You can see the same spread that we can on bills cash, so I mean we have run a rolling three month average, which is why we get basically very little benefit at the back end of 2019, but that is a tailwind, as you said, going into 2020.

Look, in the context of the broker market, I guess a couple of things. Clearly if we can serve our customers directly we would like to. The broker channel remains an important one. It is fair to say that my comments at the Royal Commission perhaps were not positively received by everyone in the mortgage broking industry, but I think actually to the industry's credit, what has actually enabled our growth in the broker channel in subsequent periods has been because we have had very consistent speed to decision and turnaround time. So we have been able to get back to customers same day, within two days. We have seen examples in the industry of blowing out to 20 days. And in the broker channel they will preference service and reliability, which has enabled us to grow.

So I mean in the context of numbers you are using there, including Bankwest, I think for the full year, and we called out in the ASX release, we are 41% versus system of 59%. So I mean the broker channel continues to grow. It is clearly a channel that many customers preference. We would love to be able to provide obviously a very compelling direct proposition, but we recognise that the broker channel is a really important one, has been for many years and will continue to be.

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

Jarrod MARTIN: Jarrod Martin from Credit Suisse. Just looking at slide 23 and the expense waterfall, trying to get an idea of what expenses are one-off or diminishing in terms of recurring, and those that are actually recurring. So going through each of those items, so the 977, that also includes 450 extra FTE. Of that 977, how much is likely to be recurring? Then you've got

600 additional FTE, particularly risk and compliance. What's your outlook for growth in terms of FTE numbers, the IT increases, you've increased investment by $100 million this year, the outlook for that component? So I'm just trying to understand what's truly a one-off, and what's likely to recur next year, or increase next year.

Alan DOCHERTY: Yeah, we have provided some additional disclosure in both the ASX and the profit announcement around the split of those notable items in particular. There is a large component of the current year cost on the notable items related to customer remediation provisions, including a full provision for expected ongoing service fee issues related to aligned advisers. And so we have fully provided for all known issues, and as you know Jarrod we provide early and provide conservatively for those.

The program costs component of the notable items, we have called that out separately within the 977. That relates to for example a response to the APRA Prudential Inquiry through our Better Risk Outcomes program, and our work on uplifting our financial crime compliance through a program of action. So those programs of work, they are time bound but they are multi-year pieces of work. So I think that bifurcation of the notable items between remediation costs and the program costs is important in that regard.

On the enhanced risk capability, we see the items generally on the right hand side of that chart on slide 23 as being items which are in the ongoing cost base, or the enhanced risk capability, which are mentioned. We have 2,800 risk and compliance staff across Line 1 and Line 2. They are doing a really valuable job in terms of working through the issues and making sure that we make the Bank a better Bank moving forward.

If you look at FTE, on both a spot and an average basis, you will see that the exit spot FTE was actually relatively close to the average FTE over the period, and I would expect that that number in terms of risk and compliance staff would be a recurring feature as the Bank moves forward.

Other items within that right hand side, obviously we are going to continue to focus on business simplification, that is multi-year work within the staff and IT costs. There is some element of non-recurring, but generally that is, take IT costs, for example, we have increased infrastructure volumes as a result of customers continuing to migrate from physical to digital distribution channels, so again, I think you will see that as an ongoing feature of our results moving forward.

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

Victor GERMAN: Thank you very much, Victor German from Macquarie. Two questions, one on expenses, one on fees. On expenses, if I just can follow up on Jarrod's previous question, that slide relating to 23. You are still targeting absolute cost reduction. Just so we are all clear on exactly what you're targeting, would it be fair to assume that you're targeting the number ex, so you're starting by excluding remediation charges, and it backdates to your original target announced last half? In other words, you would absorb that $200 million that you have seen increasing, in 2019. I remember last year you talked about potential increases relating to bonuses and compensation, I'm just interested in how that played out this year.

And on fees, I appreciate a lot of good disclosure there, and we can see the movement from 2019 into what should be the run rate for 2020. But I'd be interested in your thoughts, maybe Matt, just broadly speaking, I mean CBA has taken a lot of initiatives, do you feel like you are now leading the market on that? Or do you feel like there's more fee pressures to come? The market is still expecting to see increase in your fee line, do you think that's a reasonable assumption over the next two years?

Matt COMYN: Yes, so why don't I answer both of those, maybe Alan if you want to talk specifically to the bonuses. So let me deal with expenses. So our commentary and guidance is very consistent with what we said at the first half. So broadly the way you described it is right. I mean, absolute cost reduction, working back from the slide that we provided there, we have also called out a sub-40% cost to income ratio obviously in a falling income environment. I know a number of you have noted for every 1% reduction in income, we have got to reduce expenses by 2.5%.

I mean, put it another way, just building on some of the things that Alan says, if you look at that enhanced risk capability, I would say a good proportion of that in my view is structural. I think it is really important that we are able to, I would like to be able to automate a lot of that over time. But I think it is really important we are able to deliver consistently good, both customer and risk outcomes.

Clearly there are elevated numbers of people around customer remediation. We want to complete that work as quickly as possible and return that money to our customers. Then if you look at the other areas where we are up to $259 million, we talked about some of them in the context of we have added additional people into our, what we call Financial Assistance Solution, which is also the teams that deal with customers who are in arrears. It is probably the primary reason that we have been able to improve our 90 day home loan arrears rate for example. We have added extra home lending, business bankers. We have added extra staff to deal with complaints, particularly dealing with the introduction of the new Australian Financial Complaints Authority.

So we sort of feel like in many of those areas we have got a good return on that investment. An extremely good, in some cases, return. But then when you get to the 190, given that softening revenue environment, we just feel like, and there is genuine cost out there from simplification, and much better cost discipline, there is just more work to do there. And we have got to be able to demonstrate that next year.

Then maybe your question on fees. So I mean the majority, I guess I would say our outlook overall on OBI, in particular, is basically stabilising from that point. So the majority of that shift from 275 to 415, a lot of that is the full year effect of fee changes that we have made, particularly in our Wealth business, so in our

CFS business. I think there was only one month of the $70-odd million, for example, within that. So as you said we tried to call all of that out in the third quarter.

We feel like we have made absolutely the right steps and some deliberate choices. We also believe very strongly in transparency. So providing some of that alerting capability, but I think overall we are in a good position. And obviously with volume growth, there are some areas we would like to see an uptick in fee income as well.

Alan DOCHERTY: On bonus fees, you will recall this time last year, we had significant reductions in equity-based compensation, deferred equity for a number of senior Executives. So we have seen that come back to more normal levels in the current year. So that has been an element of headwind within our operating expense base, and you can see that in detail on the operating expense note in the profit announcement.

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

Andrew LYONS: Thanks, Andrew Lyons from Goldman Sachs. Just a question on your NIM. The disclosure around the impact of the cash rate cuts, the data has been very helpful. But the market's now pricing close to two further cash rate cuts by early next year. I assume you're not going to give us any guidance around what that might mean for the NIM, but is it fair to assume that just given where various deposit products are now, pricing, that the impact of a further two cash rate cuts would be more than the first two?

Then just a second question, you note the 9% increase in your investment spend. A big increase, well, all of the increase in that came from compliance at the expense of productivity, growth and other. I'm just wondering with a $1.4 billion investment spend budget for the year, are you comfortable that you can maintain adequate non-risk and compliance spend within that?

Matt COMYN: Why don't I, and Alan please add, as you said we call out the four basis points. I guess it is a combination of the impact of the rates, as well as just a shift in the yield curve, and therefore the tractor or the earn rate on both the replicating portfolio and the duration of equity. Similarly we have priced in, well, one more cash rate. No, we are not giving the specific impact, but your overall assumption that each subsequent rate reduction costs more, is right. We called that out when we did the latest pricing change, that there is $160 billion of deposits where we currently either cannot pass on at all, or in full. As you would expect that pool of deposits both grows, and the impact of that limited pass through increases.

In the context of the question on investment spend, yes, I mean look we are very comfortable with that level of investments, it was a modest increase. We have got about 5,500 people working on projects. We feel like we are constrained more in the context of capability and capacity and our ability to deliver and execute and get a good return on that investment. We feel that there is enough envelope, clearly, within that to invest in the necessary regulatory and compliance, but if at any point over the long term we thought it was necessary to invest more to strengthen our overall franchise, then we would be prepared to do that, subject, of course, to having availability of the right level of resources.

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

James ELLIS: Thank you. It's James Ellis from Bank of America and Merrill Lynch. Question on costs and a question on the Business and Institutional balances. So we've seen continued contraction in Business and Institutional, just wondering to what extent you expect that to continue into future periods, or whether we're done there? Then secondly, your strategic cost program, you've obviously not put a target in terms of when you expect to achieve those strategic outcomes, but on the one hand it's six months. So you've got whatever point in time that is, it's a bit closer, but then you're calling out a tougher revenue environment. So certainly the cost to income ratio component of the target is maybe a little bit further away. So does it feel like it's getting close or further away at that point in time? So Business and Institutional balance contraction and is it getting further or closer?

Matt COMYN: Yeah, look I mean the costs, we have said, I think a number of times, we are basically targeting that over the medium term. I appreciate that is not a particularly helpful descriptor. I do not have anything more beyond that other than to say, clearly it is something that is at the forefront of our mind, but we are going to be prepared to make the right choices rather than slavishly hold ourselves to that target in any sort of six month period.

On the Institutional Bank performance, as I called out, we are very comfortable with the discipline focus on both price and risk. That $2 billion of organic capital in the last 12 months has been extremely effective. Some of that gets harder in the context of go forward. So I would not necessarily base that level of rate of reduction and balances certainly going forward. We want to support the Institutional Bank. It is a really important part of our overall business in serving our customers. We are also conscious that we want to make sure that we are able to earn the right level of both risk and return in that business.

James ELLIS: Thank you.

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

Andrew TRIGGS: Thank you, it's Andrew Triggs from JP Morgan. Two questions, please, the first one on the consumer finance portfolio. Looking at the average balance sheet, the yield in that book continues to fall by about 20 basis points this half, 27 basis points last half. Just an idea, a sense of if that magnitude is likely to continue and what the sort of dynamics are at work there?

And the second question, the interest only, well the percentage of flows in interest only down to 22% and now in line with the percentage of the portfolio, 22%, does this imply that the drag from switching is likely to be very little going forward? Or could we see a scenario where the percentage of the book dips below the percentage of flows?

Matt COMYN: Yes, why don't I take consumer finance. I mean there are a couple of things that are happening within that book. First of all, just much lower growth, both on their credit side, as well as personal loans. I mean our balances there are shrinking and we are gaining share. I mean the other thing that is changing there in the context of what is impacting net interest margin is the revolve rate, so the proportion of balances that are attracting interest. So that has continued to come down.

Sorry, your second question was …?

Andrew TRIGGS: Sorry just …

Matt COMYN: Oh stock portfolio in terms of the headwind. Yes, that is the right assumption. I mean when we think about switching, I guess there is a couple of different elements to that. One is, switching from interest only to principle and interest. Another is investor to owner/occupier and other is variable to fixed. The majority of that headwind that we have been experiencing has been around interest only, switching to P&I. And exactly as you said when stock equals flow, you assume that that drag in future periods is going to reduce and stabilise.

Alan DOCHERTY: That sequential margin, drop in consumer finance was the other factor at play there. Of course, the Treasury reforms to credit card interest, they were effective from 1 January this year, so you see that is the major driver of the sequential move in yields.

Matt COMYN: Yes, I think in the third quarter we called out a $52 million full year impact. So it works out basically half that in this Result.

Melanie KIRK: Great, we will take the next question from Richard Wiles.

Richard WILES: Good morning, Richard Wiles from Morgan Stanley. A couple of questions, one on dividend and the other on capital and investment. I will start with the latter. It looks like you got $6 billion plus of surplus capital above the 10.5% minimum once you get that life company deal done. What is the potential or are you considering taking some of that $6 billion and investing it back in the business, accelerating the investment in order to respond to the changes in the environment?

Second question relates to the dividend. In 2015 your ROE was 18%, your payout ratio was 75%. Today the ROE is less than 13%. So it's fallen by five percentage points. The dividend payout ratio, if you exclude the notable items is 80%. So I would just like to know how you are thinking about sustainability of the dividend? Is it appropriate to have a higher payout ratio when your ROE is so much lower? And do you expect the payout ratio to get back to 75% or do you think it just stays above 80% in the future and that's okay?

Matt COMYN: Look I am happy to make a start, and then Alan, why don't you add to that? Look I mean there are multiple elements obviously embedded within that question, Richard. I mean one of the ways that we think about, why don't we just talk about the dividend to start with. No change to the payout ratio. I think that has served the organisation well for some time. Clearly we are outside the payout ratio at the upper end, including notables and above it. Sorry, excluding notables and above it, including notables. We still feel that that payout ratio is appropriate.

It is a lower growth environment. So what are some of the things that we are thinking about or the Board, which is making that decision on dividends at any point in time, is considering both at this stage. Obviously the overall capital position, as well as growth, return on equity is an important driver in terms of what that payout can be. We are in a lower credit growth environment, so we are going to have lower RWA growth. So I think being, just working it through, being at the upper end of that payout range is not a particular problem.

In the context of our capital position, as you said, where we stand today, including both the Asset Management business sale as well as other capital that should be received subject to various regulatory approvals and those divestments completing, then again, that is a Board decision. It is something that we talk about on a monthly basis in the context of how we are thinking about our overall capital plan and strategy.

There is not much more that we can say at this point, other than clearly as we are getting into a position of surplus capital, we will continue to invest in our business, but the reasonable expectation that a good proportion of that surplus capital will be returned to shareholders at the appropriate time, subject to operating conditions and subject to the Board's decision.

Alan DOCHERTY: And the other context Richard around the historic dividend payout ratio in the middle of that range of 75%. That has obviously been in the context of a period of capital build over many years. And so the very strong muscle that we have developed, capital discipline and organic capital generation, just I think provides the Board with additional flexibility as we work through the various considerations as we manage capital into the future.

Melanie KIRK: We are going to take the next question from the phone and we have got Brendan from Citi on the phone.

Brendan SPROULES: Good morning, it's Brendan from Citigroup, just coming through, I've got two questions. Firstly on the home lending market, obviously you have been able to restore your growth relative to system in the last six months and Matt, you've mentioned the ability to execute better in the broker channels. I was wondering if you could talk about front book pricing in that market, particularly now that we've had two RBA rate cuts. To what extent are prices still well south of where your average back book is?

And my second question relates to the Institutional Business. You've obviously had quite a bit of lending book contraction over the past couple of years. I was wondering what the outlook for the cost base in that business and whether there'll be a consummate reduction in the operating costs looking forward?

Matt COMYN: Sure. So why don't I start on home lending, and then I will let Alan talk to the cost base around Institutional. I mean overall the level of discounting, at least as we see it, is relatively flat over the course of the 12 months, in terms of particularly the discounting away from the standard variable rate. What we have seen increasingly come into the market is a number of institutions competing heavily, particularly around cash back offers. What started out as a cash back around refinance, then became a cash back on any new loan, then it became a cash back on multiple securities. So the cost of how that manifests itself generally, is it will be capitalised and then amortised over the life of the loan. So if you are doing $2,000.00 cashbacks, 10,000 loans a month, you are building up a cost base there of $20 million a month. So we are watching that dynamic very carefully.

As you would appreciate, there is intense competition. We see that flow through in terms of for every customer that we are serving on a day to day basis, there is also increasing recognition and transparency about what sort of pricing would be available. So you see existing customers, even a refinance, it is probably a relatively low rate on a historical basis. That is not to say there are not customers that are actively approaching and wanting to negotiate on a home loan. So we see those various dynamics show up in how we think about asset pricing overall. And some of the loans that have been repaid are at higher margins than those that we are originating today. So that has also been a drag in the period on home loan pricing overall.

Alan DOCHERTY: And on Institutional Banking, I mean obviously Andrew and the team are looking very hard and have been over the past 18 months, two years around right sizing the cost base as we see the lower revenue environment. You would have seen in the period, the costs were down 2.2% in the Institutional Bank year on year. In the prior year we had a software impairment and so there was on an underlying basis, a good momentum built from the tail end of last year in the institutional cost space. And if you look at cost to income ratio, it is still at the low end of the range for an Institutional Bank. So we have got a cost to income ratio in the 42%, 43%. So as we right size the portfolio mix and the mix of capital intense lending revenues within the Institutional Bank, Andrew and the team are very focused on right sizing the cost base commensurate with the top line.

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

Brett LE MESURIER: Brett Le Mesurier from Shaw & Partners. Was it your intention to indicate that the net interest margin would be 2.05% in the most likely outcome for this financial year?

Matt COMYN: As you know Brett, we do not provide guidance on the net interest margin.

Brett LE MESURIER: No, but given what you said about the headwinds and starting at 210 that's the logical conclusion.

Alan DOCHERTY: Yep.

Brett LE MESURIER: Was that what you intended to imply?

Alan DOCHERTY: No, I mean what we have sought to do is provide some transparency around known events, or one known event, as we have got a new lease accounting standard, and under that new lease accounting standard we have to bring in a new interest expense to accounts, so clarifying the outlook on that basis. And we have also had two known events in terms of two recent cash rate cuts. And so given some transparency around not just the impact of those rate cuts themselves, but also the lower yield curves and the impact that has on our replicating and equity tractors, because they are difficult to model. So we thought we would provide some additional clarity around that aspect. But they are both known events, there are a lot of other variables, as you know within net interest margin, we are not seeking to try and second guess a number of other variables.

Brett LE MESURIER: Just moving onto the disclosure that you gave on transaction balances on slide 14, you said they were up 9%. When I look in the average balance sheet, I find no growth in transaction balances from the first half to the second half.

Alan DOCHERTY: Are you including non-interest bearing deposits in that?

Brett LE MESURIER: They didn't move either, non-interest bearing liabilities is the disclosure you give, they didn't move either. So can you reconcile the large increase that you show in the slide pack against what we see in the average balance sheet?

Matt COMYN: Well, I can reconcile insofar as the vast majority of the growth would be in the first half, versus the sequentially. So if you did the balances in terms of a full year, year on year, but I would have to look at it. But I am sure the calculation works, but I do not have the sequential breakdown in terms of balance growth.

Brett LE MESURIER: The transaction balances in that slide pack, they include mortgage offset accounts I presume, is that correct?

Matt COMYN: They would, yes.

Alan DOCHERTY: Both transaction deposits on an average balance basis are up on both full year, and you can see over each of the three halves.

Melanie KIRK: Great. We will take the last question from Azib

Khan on the phone, so we will turn to the phones again.

Azib KHAN: Thanks Mel. Matt, you mentioned early in your presentation that in terms of the Remedial Action Plan you have completed 75 milestones out of the 156. Is your expectation that once you have completed all 156 the $1 billion operational risk capital add-on will be removed?

And my second question is about potential NIM tailwinds. You have already covered the basis risk part. But in terms of your deposit mix, that's obviously changing favourably at the moment. You're experiencing strong growth in your transaction deposits, and contraction in your term deposit book. Presumably at least some of that dynamic is due to the lower rates being offered on TDs. So if we see further cash rate reductions, is your expectation that there'll be a further favourable change in that customer deposit mix? And also on NIM tailwinds, can we expect the portfolio optimisation initiatives that you're undertaking in IB&M to be margin positive? And one of the reasons I'm asking this last part of the question is because you have been conducting some optimisation in the Institutional loan book for the last 12 or 18 months, but we've seen the NIM contract. Can you explain why that NIM in IB&M has been contracting?

Matt COMYN: Yes, so Alan, why don't you take the IB&M NIM. Let me deal with the first two parts of your question. So look, the milestones in the context of completing the overall program, basically one of the conditions of the enforceable undertaking as you said was that op risk capital. It is incumbent on us to be able to demonstrate to APRA and to make an application for either a partial or at the appropriate time perhaps a full reduction. One would think it's very closely linked to the delivery of the program, but of course it is up to us to be able to demonstrate that.

Secondly, I mean on the NIM tailwind, or just around deposits, there are obviously a number of different dynamics there. So first of all, in a falling interest rate environment as I said, that $160 billion of deposits gets larger, it is a bigger impact from subsequent cash rate reductions. I mean, the term deposit pricing at the moment is very low margin business, in some cases as the yield curves fell quite rapidly, there was a period there of probably negative margin before rates really are adjusted. So I mean there are a lot of different dynamics to try and then translate even then for us how that plays out. Of course an element of that is going to be competitive intensity for deposits as well. We certainly will be very focused on our transaction banking franchise, we think the ability to be able to perform well there gives us very strong liability led funding advantage.

Alan DOCHERTY: And on Institutional Banking, yes, the portfolio optimisation within the Institutional Bank translates an improved portfolio mix, so improved lending margins at a Group level. If I then look at a divisional Institutional Banking and Markets margin, that is up two basis points over the year, although there is an offsetting dilutive effect of the lower yield environment. That lower yield environment translates into lower net interest income in our markets business, and so that has a dilutive effect on net interest margin relative to the dynamic we have seen on lending mix.

Melanie KIRK: That brings the briefing to a conclusion. Thank you for joining us, and if you have any follow up questions please reach out to the Investor Relations Team. Thank you.

END OF TRANSCRIPT