Start of Transcript

Introduction

Melanie Kirk: Hello and welcome to the Commonwealth Bank of Australia's results briefing for the year ended 30 June 2021. I'm Melanie Kirk, and I'm Head of Investor Relations. Thank you for joining us for our virtual results briefing.

We are coming to you from Sydney, that is currently subject to COVID-19 health restrictions. Our briefing is compliant with the New South Wales Government COVID Safe requirements, and our own strict safety standards.

For this briefing, we will have presentations from our CEO, Matt Comyn, with an update on our business and an overview of the results. Our CFO, Alan Docherty will provide an update on the details of the financial results, and Matt will provide an outlook and summary.

The presentations will be followed by the opportunity for analysts and investors to ask questions. I'll now hand over to Matt. Thank you, Matt.

CEO Presentation

Matt Comyn: Thanks very much, Mel. Good morning to everyone. It's been a challenging 12 months for many in Australia and around the world. We are watching the situation in greater Sydney and other parts of the country closely, and our thoughts are with those impacted.

Throughout the year, we've been very focused on supporting our customers. We've also been very focused on disciplined execution which has delivered above system volume growth in all core markets, cash NPAT up 19.8%.

We've continued to strengthen our balance sheet, which has allowed us to declare a final dividend of $2.00, bringing the full year dividend to $3.50, and we've announced a $6 billion off-market share buy-back.

We've also been focused on delivering our strategy, building tomorrow's bank today, which has included helping to build Australia's future economy, re-imagining banking through a range of new products and partnerships, increasing our investment envelope to drive global best digital and technology, and continuing our divestment agenda.

One of the things that's really stood out this year was the discretionary effort of our people, who have really gone above and beyond to support our customers. We have managed to help households with $157 billion of lending and businesses with over $50 billion, which we've achieved by continuing to invest in differentiating our customer proposition.

We've also relied heavily on our customer engagement engine to help coordinate communications with customers across contact centres, the CommBank app, chat, e-mail, and SMS.

This has helped us to send 1.7 million personalised reminders to ensure customers know the support available to them, and effectively manage the conclusion of 250,000 loan deferrals, and support our customers as income measures – income support measures came to an end.

We remain committed to supporting our customers through the ongoing uncertainty. We've put in place a range of measures to support customers during the recent lockdown, with a particular focus on the most heavily impacted local government areas and business sectors. This includes new deferral programs for home and business loan customers.

We're currently providing two out of the five of the markets loan deferrals for small business customers and more than 50% of home loan deferrals. For home loan customers, we were initially seeing an average of about 800 applications per day, but this has stabilised to approximately 300 to 400 per day.

The demand clearly has been materially less than 18 months ago and represents less than 1% of our portfolio. We're also making sure we're supporting our people during this period and have rolled out rapid antigen testing, a COVID vaccination program to 5000 of our people, and paid vaccination leave.

Last Friday, we sent out a voluntary vaccination survey to all of our staff, and we had 11,000 of them or about a quarter of our workforce respond the same day. What that told us was that 89% of our workforce are either vaccinated or intend to do so, and 85% would participate in a corporate vaccination program.

Turning now to the results. Statutory net profit was $8.8 billion, with cash profit almost $8.7 billion, up 19.8%, reflecting the improved economic conditions and outlook, resulting in a lower loan impairment expense and strong volume growth.

Benefits from divestments, our strong balance sheet, and continued discipline on capital management resulted in a Common Equity Tier 1 capital ratio of 13.1, up 150 basis points. The year's performance and capital position has allowed the Board to declare a $2.00 dividend for the half, fully franked with a dividend reinvestment plan fully neutralised.

Operating income was up 1.7% with strong volume growth and improved fee income offset by lower rates impacting our net interest margin. Operating expenses are up 3.3% driven by volume-related expenses, continued investment in the franchise, and further customer remediation.

Our loan impairment expense decreased substantially to seven basis points due to low loss experience and an improvement in economic conditions. Our loan loss ratio has averaged 20 basis points over the last two years, which is broadly in line with our long-run average.

Our core businesses continue to perform very strongly with above system growth in all key product lines. We continue to process record numbers of home loan applications, contributing to home loan balance growth of 6.7% at 1.2x system.

Household deposits have grown 11% at 1.2x system, and retail transaction balances growing more than 25%. Our business bank continues to perform strongly with business lending growing 11% year on year at more than 3x system. The most recent half is the strongest growth we've ever seen from our business bank, with credit quality of new originations one notch better than the overall portfolio.

Over the half, we saw double digit growth in five key industries including health, agriculture, property, manufacturing, and business services. Business deposits have grown 17% and we're opening 3500 business accounts per week at the moment.

The combination of having a distinct proposition, high digital engagement, and our customer engagement engine has underpinned strong front book momentum. Home lendings – home lending new fundings are up 33% to a new record of $141 billion, with 61% originated through our proprietary channels.

Credit cards have stabilised and are showing improving front book momentum with our new interest-free instalment card, CommBank Neo representing 28% of new approvals, contributing to credit card approvals growing 50% over the prior corresponding period.

Transaction balances are up 30% with more than 900,000 new transaction accounts opened in the past 12 months. Our business lending market share is up 90 basis points to

15.6%, with business deposit market share up 210 basis points in the past two years, and CommSec continues to perform strongly, with over 550,000 accounts opened this year and trade value up 37% over the year.

During this year, we simultaneously hit number 1 in net promoter score across consumer, business, and institutional. Despite this, we still have much more work to do to increase our absolute net promoter scores and to regain number 1 in consumer.

We see the CommBank app enabling us to move beyond customer service, to redefining and extending the relationship we have with our customers. Over the course of the pandemic, our customers embraced digital banking in record numbers.

Our mobile banking app continues to lead the market with a net promoter score of 30.

Digitisation and technology helped to drive strong operational performance in home lending. 65% of all home loan applications are auto-decisioned the same day, and 85% of referred applications are decisioned same day for proprietary and in two days for broker.

In business lending we focused activity on our customer engagement and turnaround times, and are now able to decision and fund a loan through BizExpress is under 12 minutes.

As you can see, our balance sheet remains strong, with 73% deposit funding, a slight decrease due to the long - to the term funding facility. We have seen troublesome and impaired assets down $1.2 billion in the year, and $700 million in the half. We are well-provisioned, with total provisions if $6.2 billion and overlays of approximately $900 million given the ongoing uncertainty.

Our Common Equity Tier 1 capital ratio represents approximately $12 billion in surplus capital, above unquestionably strong levels. This has put us in a strong position to be able to complete a $6 billion off-market share buyback and still retain a large capital surplus.

Participating domestic shareholders will benefit from the distribution of surplus franking credits, and non-participating shareholders will benefit from higher dividends over time, given the lower share count.

Earlier this year we refreshed our strategy to set a more ambitious agenda to build tomorrow's bank today for our customers. We have set four strategic priorities which are (1) leadership in Australia's economic recovery and transition, (2) reimagine products and services, (3) global best digital experiences and technology, and (4) simpler, better foundations. I will spend a few moments sharing our progress on each of these.

I have already talked about how we are supporting both households and small businesses who play such a critical role in job creation and economic growth. We also remain focused on building Australia's future economy. We have helped our clients access $175 billion in funding, and for the first time ever ranked number 1 in Australian debt markets.

It's also a focus to support the country towards a lower carbon economy. This year we have been involved in $6.9 billion of sustainability bond arrangements. We have rolled out our green loan nationally for home loan customers, who can now access funding at 0.99% for 10 years to install solar panels or a battery for their home.

Our second strategic priority is to reimagine our products and services. This starts with making sure we deeply understand our customers and can anticipate their needs. These insights allow us to shape our customer proposition by reimagining products inside our core, by building new services in our digital channels, by scaling new ventures through x15, and through new partnerships and equity investments.

We are looking to create a more differentiated proposition for both our retail and business customers who are looking to be rewarded for everyday spend, to buy and manage a home, and to start and grow a business. We can see further opportunities to drive sales for our 800,000 business customers, and bring greater value to our 11 million retail customers.

We want to be one of the largest, highest quality and lowest cost sources of leads for our business customers. We are now live with a new working capital product, Stream, which provides financing against unpaid invoices within 72 hours. We also announced a partnership this year with BigCommerce to help retailers get online. Our CommBank iQ goes live in two weeks, and gives our institutional banking clients unique insights to their businesses based off 40% of Australia's payment transaction data, and 1300 customer data attributes.

We also announced earlier this year the acquisitions of Whitecoat and Doshii, which we see as differentiators in the health care and hospitality industry verticals. Whitecoat helps to simplify payment flows for the health care industry. Doshii looks to simplify the process of taking a hospitality venue online. Doshii has facilitated over 58 million orders this year, and grown its venue base by 38%.

We know that the most important thing for home buying customers is the certainty that comes from a quick decision and making the bank easy to deal with. We are also thinking more broadly about how we help customers with their home buying journey. Conveyancing is a point of friction for customers. We have made available to all customers our conveyancing solution, Home-in, which passes on the benefits of a more digitised process through lower costs to customers. Customer feedback has been strong, with a net promoter score above 60, and a 5 percentage point increase in conversion rates.

We are also saving customers money on their utility bills through our partnerships with Amber and More Telcom, and at the same time, help accelerate the growth of these digital disrupters.

Helping customers with their everyday spending remains a huge focus, particularly buy now pay later. Our pay in four product, StepPay, will be one-quarter of the cost for the average merchant and allows customers to buy anything in four instalments at no cost if they pay on time. 80,000 customers have pre-registered. It is now live in pilot, and will be rolled out to all customers this month.

Little Birdie is now also live in market, with over 75 million items showcased. From later this year there will be exclusive offers presented in the CommBank app to help bring value to our customers and drive sales for merchants.

Our partnership with Klarna remains a key part of our buy now pay later strategy. We have a 5% equity stake in Klarna and a 50% economic interest in the Australian and New Zealand businesses. Klarna now has over 1000 signed merchants in Australia and 1 million customer downloads, and is also live in New Zealand.

From October we will begin replacing our smart terminal fleet with a new point of sale device, with a range of apps available, including Doshii and Whitecoat. Later this year we will also commence a pilot of a new compact and fully mobile tap-and-pay reader which our customers will be able to get in-branch, immediately ready to accept payments.

Later this year we will also be launching a next generation home loan proposition called Unloan, which is direct to consumer and fully digital end-to-end. It’s built in the cloud, using the latest software as a service applications, which ingest a range of data feeds, including through Open Banking, as well as APIs from CBA's core systems to enable a seamless experience for customers.

Our third strategic priority is global best digital experiences and technology. We have increased our investment spend this year by 26%, with digital now representing 20% of our total spend. We are recruiting 600 engineers in Australia this year. To complement this we have also opened an office in India to increase our access to global best talent.

We have accelerated our move to the cloud with over 43% of total compute now in the cloud. In parallel, we have large programs of work underway to simplify and modernise our technology estate, including retiring old systems and rehosting or modernising systems which are end-of-life. We are seeing the benefits of some of these investments in terms of automation and turnaround times in both home lending and business banking.

We are using technology to build deeper, trusted relationships with our 7.5 million digitally active customers by moving beyond customer service to delivering more rewarding experiences and better outcomes. Our customer engagement engine allows us to orchestrate relevant and personalised experiences, supported by over 400 machine learning models running across 157 billion data points.

New ways we are helping our customers through the CommBank app include our Cash Flow View, which is helping 830,000 customers get a complete picture of their income, spending and saving each month. Bill Sense, which has made over 60 million bill predictions for more than 450,000 of our customers. By bringing these predictive features together with our new income and expense smoothing products we can increasingly ensure our customers never miss a payment.

We have invested significantly over the past few years building a simpler, better bank. We have made further progress simplifying the business completing a number of divestments in the period. We continue our long-term focus on disciplined costs and capital management. We have now submitted all milestones of our remedial action plan. We will continue to focus on embedding and sustaining these improvements.

Culture continues to be a huge area of focus for us. We have seen the positive impact this focus has had on our people with employee engagement at 78%, and our people's sense of pride in the organisation at 88%.

I will now hand to Alan to take you through the result in a bit more detail.

CFO Presentation

Alan Docherty: Thank you Matt, and good morning. I will step through the financial results in more detail, and also provide some further colour on our capital management and dividend considerations. In summary terms, this result is reflective of a disciplined and consistent execution of our strategy and is underpinned by structural competitive advantages that have been built over many years, and that we look to invest in, maintain and strengthen.

This combination of execution discipline and franchise strength has meant that we can step up and support our customers and the broader economy during tough times, and also deliver strong and sustainable returns to the shareholders of the Commonwealth Bank.

The most pleasing aspect of this particular result is the consistency of execution across all of our core businesses. Our people in the Business Bank, the Retail Bank, the Institutional Bank, and the ASB in New Zealand have executed exceptionally well this year. They have supported our customers, and we are seeing an improving trend in customer advocacy in each business unit.

We have also had a step-change increase in the amount of investment that we make in all of those businesses. This is to ensure that we can keep strengthening the franchise in the face of an evolving competitive and regulatory context.

We have also been pleased with the financial and risk discipline shown by each of the businesses this year. Margins have been managed well. This has limited the impact of the low rate environment on our top line.

Credit risk outcomes have also been strong, and as we further embed better capital disciplines we have seen another strong period of organic capital generation. This is reflected in the delivery of a strong set of outcomes this financial year, with market share gains in all core products, improved revenue momentum, and the opportunity to commence the return of excess capital to our shareholders.

Now onto the detail. Let me start off as usual with a reconciliation of total statutory profit to continuing cash profit. Statutory profit from continuing operations was $8.8 billion for the year. After adjusting out one-off divestment gains and hedge accounting volatility we delivered continuing cash profits of almost $8.7 billion.

As Matt has described, that cash profit is up 20% over the year, with operating income growth of 1.7%. Operating expenses up 3.3%. A positive pre-provision operating performance and loan impairment expense falling significantly, with the prior period including that large increase in provisioning during the first few months of the pandemic.

I will step through each of these P&L items in a bit more detail, before drilling into the balance sheet, dividend and capital management considerations. Looking firstly at operating income. Both net interest income and other banking income increased over the year. That was largely a function of strong volume driven growth in home lending and business lending revenues in both Australia and New Zealand.

That drove most of the growth in net interest income and lending fees with CommSec posting another good result on higher trading volumes.

Other banking income also benefited from higher one-off profits from the revaluation of our minority investment stakes. Institutional bank lending balances contracted due to lower levels of client demand and a highly liquid capital market. However, they managed to stable - deliver stable divisional revenues through higher lending margins and the strong performance of the global markets business.

Revenue growth was of course impacted by a four basis point fall in net interest margins over the year. On the top left of this chart, we've decomposed that movement into three component parts. Firstly, we've got the dilutive effect of higher liquid assets which cost us four basis points. Secondly, lower rates cost us six basis points. You will recall that we guided to a seven basis point headwind this time last year and we did a little better than that due to the rise in long-term yields that occurred between February and June.

Lastly, we clawed back six basis points through good margin management, particularly on the liability side of the balance sheet and the funding benefit from both lower basis risk and the term funding facility. Over the most recent six months, margins increased three basis points. The dilutive effect of higher liquids and lower rates were already largely embedded in our net interest margin in the first half and those positive margin drivers that I just described were weighted towards the second half.

As we look ahead to the next financial year, it's difficult to provide useful quantitative guidance on the margin outlook. We know that low interest rates will continue to feed through into lower returns for our deposit and equity hedges. We expect price competition will remain intense across our key lending portfolios and on the other side of the balance sheet, we are now seeing our competitors bid up pricing to attract deposits.

We expect that customer preference for lower margin fixed-rate home loans will remain high and also, expect unfavourable deposit mix effects as balances gradually switch into higher rate deposit products. Against that, we will obviously see a benefit from lower wholesale funding costs from the term funding facility.

In summary, there are more headwinds than tailwinds and we'll need to continue to be focused and disciplined on margin management to do what we can to offset those pressures. Operating expenses increased 3.3% on the comparative period. Remediation costs increased $140 million over the year, probably the most disappointing aspect of these results and again, includes top-up provisioning for historical wealth management related issues.

Excluding that, underlying cost we're up 2.4%. The biggest driver of the cost increase was a decision we made to rebase our investment spend envelope upwards from around $1.4 billion last year to $1.8 billion this year, nearly 60% of which is expensed. This added 1.8% to our underlying cost growth this period. We believe this additional spending is crucial to the long-term health of the franchise. We are seeing the benefits of this spend in better customer outcomes, better operational risk management and better digital capabilities.

As you can see, volume-related costs increased 1.1% over the year, reflecting strength in new origination flows and investment in frontline business bankers and retail lenders. Lastly, our ongoing business simplification initiatives resulted in incremental productivity savings of $321 million which have more than offset other inflationary cost increases.

Turning to our balance sheet settings and looking firstly at credit risk, loan impairment expense fell significantly across both our consumer and corporate portfolios. The low absolute level of consumer arrears across all retail portfolios reflects the strong recovery in economic conditions that we experienced through most of last year. We do expect to see continued modest increases in home loan arrears rates, off this very low base from those customers most impacted by lockdowns, particularly within the greater Sydney region.

Pleasingly, troublesome and impaired assets continue to fall down another $700 million in the last six months and are now below pre-COVID levels on both an absolute basis and as a percentage of total committed exposures. These strong portfolio trends, along with an improved macroeconomic performance and outlook have resulted in a reduction to our loan loss provisioning. Collective provisions are down approximately $600 million over the last six months and are back around the level of provisioning that we held this time last year.

As you can see on the right-hand side of this slide, we have continued to exercise caution around the level of provisioning and have increased judgemental overlays in recognition of the continuing impact of the pandemic on our customers and the economy. We are comfortably provided for a range of macroeconomic outcomes and we will continue to regularly reassess both our modelling and the level of our judgemental overlays as circumstances evolve.

Our balance sheet funding settings remain very strong with a customer deposit ratio of 73%, higher levels of long-term funding and short-term wholesale funding remaining at historical lows. As you can see on the right-hand side of this chart, our support of small, medium and large businesses drove an increase in our term funding facility allocation which will support continued lending growth and productive investment in the domestic economy in the years ahead.

The final dividend of $2.00 takes our full year dividend per share to $3.50 and represents a cash payout ratio of 71%. This is at the lower end of our 70% to 80% target dividend payout range, reflective of the temporary elevation of cash profits from the unwind of collective provisioning this year. Normalising for long-run average expected loss rates, this year's total dividend payments of $6.2 billion represents a payout of approximately 75% of normalised cash profit.

Given our very strong capital position, the Board have also decided to again neutralise the DRP in respect of the final dividend and as we look ahead the Board will continue to target a full year payout ratio of between 70% and 80% of cash profits, with a dividend weighted towards the second half of the year. The Board will also continue to ensure that dividend payments are sustainable and will take into account a range of factors including long run average loss rates.

On capital, we've delivered a Common Equity Tier one ratio of 13.1%, which is up 50 basis points since December. This was a result of a strong, organic capital generation of 46 basis points in the second half. Level one parent entity capital remains 20 points higher at 13.3% and our capital levels will benefit further from the completion of both the majority divestment of Colonial First State and the sale of our General Insurance business.

The Board continues to take a structured and balanced approach to the consideration of capital management activities. We will continue to reinvest between 20% and 30% of our cash profits into the retained earnings that support our long-term growth. We have again increased the level of our investment spend and will continue to invest in innovative products, services and partnerships. We will aim to continue to pay strong and sustainable dividends. We will then look to return excess capital in a manner which lowers our share count and support shareholders' long-term return on equity and dividend per share outcomes. Finally, we will continue to hold capital ratios above the unquestionably strong benchmark in order to remain resilient to potential future stress events.

Our capital surplus has now grown to $11.5 billion above the unquestionably strong benchmark. We are well placed to continue to support our customers and manage ongoing uncertainties while also returning a portion of that excess to our shareholders via $6 billion off market buy-back of shares. Together with the expected proceeds from announced divestments, this would see us with a residual pro-forma capital surplus of approximately $7.5 billion. That strong residual surplus provides the Board with the flexibility to consider further capital management initiatives taking into account a range of factors including finalisation of BASEL III requirements and target capital levels.

Lastly, in deciding to structure the capital return in the form of an off-market buy-back of shares, the Board considered a number of factors. This form of capital return was considered the most optimal structure. Our shareholders will benefit from a lower share count which supports better return on equity and dividend per share outcomes over the long term. Domestic shareholders who participate in the buy-back will also benefit from the associated distribution of surplus franking credits.

We will now go back over to Matt who will take you through the outlook and a closing summary. Thank you.

CEO Outlook and closing summary

Matt Comyn: Thanks very much, Alan. Now, regarding the outlook, while unevenly distributed, the recovery in global growth in 2021 is underway. While Australia faces near-term challenges due to the lockdowns, we expect growth will simply be pushed back by six months, with the economy rebounding in late 2021 and growing strongly in 2022.

We see a number of factors supporting growth, including the significant accumulated household savings, a swift employment recovery due to low supply of labour, expansionary fiscal and monetary support and the strong housing market that has been a key area of support for the economy. The New Zealand economy is also in a very strong position with the RBNZ expected to raise interest rates. Looking ahead, we see a number of upside and downside risks, in particular the ongoing management of COVID-19 outbreaks and new variants, with the vaccine rollout being critical, and ongoing global trade and geopolitical tensions.

In summary, we are committed to supporting our customers and communities through any ongoing uncertainty. Our strong focus on customer needs, engage people and disciplined execution has delivered very strong operational performance and delivered balanced outcomes across all stakeholder groups. We've continued to strengthen our balance sheet allowing us to announce a $6 billion off-market share buy-back. We are extremely focused on accelerating the pace of innovation and building distinct products and services for our customers. I will now hand you back to Mel to go through the questions.

Q&A

Melanie Kirk: Thank you, Matt. For this briefing we will be taking questions from analysts and investors. I will state your name and the operator will open your line. Please introduce yourself, including the organisation that you represent, and to allow others the opportunity to ask questions please limit your questions to no more than two.

We will now take the first call from Andrew Triggs.

Andrew Triggs: (J.P. Morgan, Analyst) Thanks, Mel. It's Andrew Triggs from J.P. Morgan here. A couple of questions please. Firstly, in terms of the leverage to potential rises in New Zealand rates, noting that I think the consensus is looking for three rate rises this year, any guides you can help in terms of the leverage to that move and the hedge profile that's attached to that.

Then second question just on costs, please. Incremental productivity savings appear to be getting harder to realise, I think this was the lowest incremental productivity savings number since the second half of 2019. So, I'm just interested in some comments there about whether it's getting harder to take that out.

Alan Docherty: Thanks, Andrew. Yes, in terms of the New Zealand rates we've got similar structure of the balance sheet in ASB that we have to the rest of the group and the CBA yellow brand. So, we've got obviously a large amount of transaction deposits, which do well in a rising rate environment. We've probably got a slightly higher mix of term deposits in ASB relative to the rest of the group. We've also got a replicating portfolio that operates in our ASB balance sheet on very similar tractor terms to the terms in which we operate here in Australia.

So, we are leveraged to a rising rate environment, we do apply the same balance sheet management and hedging practices on the ASB balance sheet as we apply on the CBA balance sheet, so you would expect a degree of through the cycle smoothing of the interest rate effects of rising and falling rates similar to what you see in the CBA brand. But certainly, a rise in rates and being the first developed economy to get into a rising rates cycle after prolonged periods of low rates would be a welcome sign of progress in New Zealand's economy and the broader prospects around the world.

On the productivity question, yeah, I mean we were pleased with the overall level of savings achieved over the year but, as you say, between the sequential half, the second half and the first half, the rate of improvement in the level of cumulative savings achieved did slow. I mean, we see that as a natural progression from some of the work that we've done in the early years, you've got the full run rate benefit of those initiatives now. One of the reasons that we've increased the investment envelope is that we can continue to invest and gain structural costs out of the organisation by investing in automating a number of our backend processes and so sourcing some functions that we think we can do more cost effectively in-house rather than outsource to third parties.

So, there's a number of those longer-term structural simplifications which are on foot, but which take longer, I guess, to build momentum than maybe some of the earlier initiatives did. So, we're pleased about the ongoing focus on the simplification initiatives and we're going to continue to do as much as we can to simplify and automate the backend.

Melanie Kirk: Great. Thank you, Andrew. We'll take the next question from Andrew Lyons.

Andrew Lyons: (Goldman Sachs, Analyst) Thanks, Mel. Andrew Lyons from Goldman Sachs, good morning everyone. Just a few questions just on your NIM outlook. Firstly, just on the low rate environment, in the past you have put specific guidance on this as far as the basis point headwind. I guess if cash rates do stay at 10 basis points is there any more detail that you can provide as to what the headwind might look like, albeit concede that the TFF benefit will largely offset that, you note that on slide 69 I think. I guess importantly, once we get through FY22, what does that headwind look like thereafter? Is it largely done or is there still more to come, again assuming rates where they are at the moment?

Then just a second one around the liquidity comment and the fact that you're noting that higher liquids, every $10 billion increase equals two basis points, you made the point that - well, you highlighted the LCR did fall away in the half and on the PCP, which is perhaps a little surprising in light of all the monetary support. It looks like it relates to the CLF, but I'm just wondering if you can talk to how much additional liquids you think you need to put into the balance sheet in FY22? Thanks.

Alan Docherty: Thanks, Andrew. So first point on the NIM outlook, yes, I guess there's a number of moving points that we've endeavoured to highlight here. In the past, we've provided quantitative guidance. This year I think just given the number of moving parts I think that's less helpful, so I think providing the key qualitative moving parts that we've got our eye on and to the point, yes, we've included some additional disclosure on slide 64, which unpacks a couple of those items in a bit more detail. So, we've provided as usual what the average rate was that we were earning on both the deposit and equity hedges. We've looked at the exit rate on those. So, you can see that given a three year term on the equity hedge and a five year term on the deposit hedge, you're going to see those rates to the extent that long-term yield remain at current levels, you're going to see that being a continued drag on net interest margin over the next number of years.

We've made the comment that in the next 12 months the term funding facility will certainly help by lowering wholesale funding costs. That will provide an offset to the deposit and equity hedge impact in 2022. But as you rightly point out, beyond 2022 you'll have the full benefit of the TFF but we'll continue to see further margin contraction from the deposit and equity hedges, on the assumption that long-term yields remain where they are at the moment. So yes, we've put the key factors there. The other one obviously is the level of basis risk in the economy, that's remained at zero. We've got a three basis point benefit from that over the last financial year, that's unlikely to be repeated obviously, and we're watching closely how basis risk moves in the period ahead.

To your second point on liquids, yes, the key reason the liquids fell was really the reduction in the committed liquidity facility. Which is an industry-wide reduction, reflective of the fact that we've got a lot more liquidity in the domestic bond market, in the domestic government bond market, and so that takes up the slack. So, if anything in the previous year around 140%, mid 140% LCL is probably a little high relative to where it would run

LCR from a target perspective, and so we’re comfortable with where that level of liquidity is at the moment.

If you look at our balance sheet, you’ll notice that there’s a very large spike in cash and liquid assets at 30 June relative to 31 December. A lot of that increase is due to the drawdown of the term funding facility.

We drew a lot of the term funding facility down right at the end of the financial year, so that comes through the spike in spot liquids which will roll through in terms of the impact on net interest margin in the months ahead, and so we would expect to see that the average level of liquidity will be a little higher than we've seen averagely over the last quarter of the financial year.

Matt Comyn: Andrew, the only thing I'd add is to underscore Alan's comments, particularly on the NIM side, would be in the home loan portfolio, and two factors. One just the ongoing competitive intensity there and then two, the compression from switching to fixed rates. I think we're something like 44% new originations at fixed. It was spotting higher than that, and as you probably appreciate, there's a significant margin differential between the variable and fixed, and as you flow that through into next year that's a meaningful part of that headwind as well, in combination with the intense competition there.

Melanie Kirk: Great. Thank you, Andrew. We'll take the next question from Richard Wiles.

Richard Wiles: (Morgan Stanley, Analyst) Good morning, everyone. Richard Wiles from Morgan Stanley. I've got two questions, one on credit quality and then one on your approach to revenue and expense growth. Starting with credit quality, the June data is obviously backward-looking but you often publish media releases highlighting the insights from your real-time data. What's that real-time data saying about the impact of the lockdowns on your small business customers and the potential impact on credit quality in the period ahead?

In terms of revenue and expense growth, back in 2019 you talked about an ambition to lower the absolute cost base, but your more recent comments have certainly emphasised ongoing investment. You did that again today. Does that mean you've returned to your previous strategy of targeting positive jaws, and if that is the case, keeping in mind that jaws were negative in the full year but turned positive in the second half this year, are you confident of delivering positive jaws in the year ahead in FY22?

Matt Comyn: Thanks, Richard. Maybe I'll make a start and if Alan wants to add anything to it. The numbers that we provided earlier in the deck and talked to in terms of deferral numbers, you'll see that they're as at 31 July. As I said, both on the consumer side I think we're seeing about 300 or 400 requests from deferrals, and on the business side it's been quite muted to date, and we believe we represent about 40% of deferrals that are in market at the moment.

That's notwithstanding the fact we've made 12,000 outbound proactive calls over the last couple of weeks, particularly to targeted sectors or customers who we think would be experiencing cash flow declines in some of the sectors you can imagine, hospitality in particular. At this stage it's been quite muted. We're certainly there to support our customers through that but we're seeing very significant difference between the deferrals and the support that was available - not so much available but taken up year-on-year, but clearly that's going to be tied to the ongoing duration of the restrictions.

To your second point, look, no change insofar as what we've said in the past about continuing to look for opportunities to reduce our absolute cost base, but I guess as we've said as well, and demonstrated in this period and the period prior, when we see opportunities to make investments in the business then we're prepared to pursue those. There's some elements of that cost growth that we're not happy about, as Alan pointed out, like elements of the remediation cost, for example, but where we're able to invest in volume-related growth, increase home lending, business lending opportunities for improving the service and turnaround time in those areas, then we're prepared to do so.

Then similarly, as we'd flagged previously, we did increase the investment spend, particularly looking to increase the investment in productivity and growth, and we think obviously innovation is going to be critical for the future, but we've also got to balance that against quality execution. For us, it's a number of the factors that we consider, as you said, jaws being one of them, but from Alan and my perspective and discussions with the Board it's a very dynamic process and we want to be judged on the decisions that we make in a particular period. I think we're happy with the decisions overall that we've made to support that above system volume growth.

Melanie Kirk: Thank you, Richard. The next call is from Matthew Wilson.

Matthew Wilson: (Evans and Partners, Analyst) Good morning, guys. Just two questions if I may. Firstly, the yield on your interest-earning assets is now 2.56%. That's below the prevailing inflation rate, so what's your strategy for protecting the real value of shareholders' funds in this strange environment where central banks are heavy?

Then secondly, when we look at your lifecycle charts, you continue to lose market share in that 18-34-year-old age group, which is critical, and if we go back to December '19 it looks as though you've lost 5 to 6 percentage points or 10% of that customer base. Given that you are investing heavily in modern digital products that should appeal to that younger cohort, why aren't we seeing it in the ability to defend your market share there?

Matt Comyn: Thanks, Matt. Maybe I'll start and Alan, feel free to add. Maybe Mel can help me with the slide. I remember answering the question I think at the half when we saw a reduction particularly in that MFI chart and the explanation I said at the time, which I didn't think fully explained it, was around reduction in migrants. What we've seen, and you see we've restated so you can't really do a five or a 10-year backward-looking comparison but we've restated because as we dug into it more the provider of that particular survey had changed their methodology.

There was a higher predominance of face-to-face interviews in a pre-COVID world, and so that actually accounts for the vast majority of the change. I think as you look across more recent periods you can see in some sectors we've grown some share. It continues to be, I guess as we've always said, directionally we hope accurate, probably precisely no more so than any other survey could be but remains obviously a really important part of our strategy. We monitor that closely internally.

We want to be of course relevant for all of our customers, but particularly across the new sources of customer growth which have typically served us very well over many decades, particularly youth and migrant. There's a lot of the work that we're doing in some of these customer propositions to make sure that we maintain our relevance to those cohorts.

Then on your first question, and I know Alan will probably add to this as well, look, it's clearly a very challenging scenario for banks all around the world with record low rates. We see the drag of that coming into this year and Alan pointed it out at the start of the year, guiding on 6 basis points of NIM compression. That's basically the best part of $500 million of net interest income, start the year behind, there has been strong volume growth.

We've tried to manage that margin as best we can on both the asset and liability side, obviously looking at all of our settings across the balance sheet regularly to try and deliver the best overall outcome, but we're going to feel continuing pressure on net interest margin for the foreseeable future and certainly until we start to see more of a rising interest rate cycle.

Alan Docherty: Yes, and just maybe to add a bit of colour to Matt's comments on the spreads. Yes, certainly the spreads have come down, a function of the very low-rate environment and in terms of what we can do about that, well, one of the things we can do is just execute really well in terms of the core product volume growth and operational execution. I think the teams have done a really good job in that regard.

I also mentioned the liability side of the balance sheet and the margin management, so although that spread has fallen to 2.56% as you see in the recent half, the liability side has fallen more than that so we've actually delivered an increased level of net interest spread before the free equity flow. Again, that margin management risk volume, risk-adjusted return trade-off, is an incredibly important part of how we lean in against what you rightly say is a very low interest rate environment, which does impact bank profitability.

Melanie Kirk: Thank you, Matt. We'll take the next question from Brian Johnson.

Brian Johnson: (Jefferies, Analyst) Good morning, Matt. Congratulations - and Alan, congratulations on a great result. I think the execution is what really stands out. Two questions, if I may. Slide 34 where you talk about the dividend policy, what is actually the long-run loan loss rate that you actually use, and history perhaps is not a particularly good guide given that we've got so much more housing than we used to have. Could we get a feeling what you think that long-run loan loss assumption that we should be thinking about?

Alan Docherty: Thanks, Brian. We've provided some insights there into the Board's consideration around dividend. Obviously, there's a number of factors that go into the decision around any dividend but it's obvious that given we're at a cyclical high or have been at a cyclical high in terms of the provision and coverage to credit risk-weighted assets. There's certainly an additional near-term consideration is going to be the level of loan losses that we experience relative to what you might term as long-run average.

We've provided 10 years' worth of average loan loss rates in our ASX announcements so you can see that going back to the previous peak following the GFC. A number of benign yields between then and now, and obviously we had a big spike last year, and then again, another benign period in the most recent 12 months.

Anyway, you can I think derive from that and your own views on the industry over many years what a long-run average loss rate is. I don't want to get into specific numbers of basis points because I think that gives a false sense of precision around the wide variety of factors that goes into deciding any single period's dividend, but yeah, it's certainly going to be an additional factor in the near term for the Board.

Matt Comyn: I think he had a second question.

Brian Johnson: (Jefferies, Analyst) How much of the term funding facility drawdowns is actually parked in the RBA exchange settlement accounts earning zero, and what is the prospect to actually run down those ESA accounts? So, how much and the prospect to actually run them down?

Alan Docherty: Yes. It's fair to say, and I mentioned in response to Andrew Lyons' question, the big increase that you've seen in cash and liquid assets and the vast majority of that increase is in the RBA exchange settlement account, as you rightly say. Obviously, with the term funding facility we had until 30 June to draw that down. We then look at the level of long-term funding maturities that we have in any particular period. So, we've got around $24 billion of long-term debt maturities over the period ahead. That will obviously help with the refinancing of those exposures.

Then we have continued very strong lending momentum into this period. So, we'll continue to manage both the asset and liability side of the balance sheet. Yes, that's an ongoing focus for us from an asset and liability management perspective, but it's fair to say the exchange settlement accounts currently I think are at an all-time high for the Group, which is consistent with a lot of liquidity in the system at this point in the cycle.

Melanie Kirk: Thank you, Brian. The next caller is Victor German.

Victor German: (Macquarie, Analyst) Thank you. It's Victor from Macquarie. Two questions from me as well, if possible. First one, I was hoping to clarify your earlier comments, Alan, with respect to the slide on the offsets from TFF and margin drag from lower rates. If you could just maybe tell us at what point were the swap rates for that comment based on, because obviously there's quite a lot of volatility but we a reasonably large move since June. So, just if that comment is based on June swap rates or on current. That's the first question.

Second question on expenses, maybe for Matt. The investment spend at $1.8 billion, obviously, much higher than it is for peers. If you can maybe give us some colour in terms of flexibility that you have on that number throughout the year.

What do you think is appropriate long-term investment stance for a bank like CBA, given that, as I said, this apparent divergence between yourself and peers on that number? And if you could provide any colour in terms of where you're spending the money, what proportion is directed towards improving legacy systems which, over time, may result in a lower spend? Thank you.

Matt Comyn: Yes, thanks, Victor. Why don't I start with the second one and then Alan, you take the first? Yes, look, we - as I said, we review it regularly and we flagged previously we were looking to increase that investment spend.

We think that's critical, particularly for the medium and long-term performance of the Bank. It's a decision both around - from a financial perspective, but most often as well, we also want to make sure that we're delivering high quality execution and there's constraints in terms of just getting the right capability and to be able to execute beyond that envelope.

As we've set out in the disclosures, we've been gradually bringing that level of expenditure in regulatory risk and compliance down. It's still a very significant proportion of our investment spend dollars, as I think it is for many banks around the world.

Of course, within the productivity and growth and some of the infrastructure-style investments, some of that is around technology simplification, modernisation, cloud migration. There's some work that we're doing on some of our core platforms and just trying to simplify and modernise the overall technology landscape to support both greater resilience as well as more rapid development and change that we can roll out to our customers.

I mean, it's hard to provide an exact ratio of what we think that investment should be. We're certainly comfortable to be investing more than peers as long as we're investing that well. We're very committed to continuing to pursue opportunities for organic growth in our franchise. We think they're well positioned. We have strong, competitive positions and competitive advantages and we want to both persist and enhance those.

I guess as we look globally and I think we particularly saw in a number of the international bank results, some of the US banks in particular, you could see a number of them increasing their investment at this point in the cycle as well.

So, I think we're comfortable with the investments that we're making at the moment. It's - well we recognise it's a significant amount of money of our owner's funds and we want to make sure that we execute that very well.

Alan Docherty: On your first question, Victor, around the swaps rates do we use? Yes, we use the latest swap rates. Obviously the three-year swap, the equity hedge. Around $57 billion hedged at that three-year rate. That's not moved very much over the past period of time so that there's not a great deal of difference there.

On the deposit hedge of $96 billion, we're exposed mostly to the five-year swap. As you say, it's come in over the last number of months although it's still a lot higher than it was a year ago. But yes, we've applied - and in the comments that I've made, the forecast, used the current level of swap which I know has been bouncing around a little bit yes, the trend overall over the last 12 months has been generally positive.

Melanie Kirk: Thank you, Victor. We will have to take the last call from Jarrod Martin. Thank you, Jarrod.

Jarrod Martin: (Credit Suisse, Analyst) Thanks, Mel. Thanks Matt and Alan. So a couple of questions. So first of all on expenses. Pretty simple question and listening to all the questions this morning, so obviously revenue is pretty challenged with - from margin perspective.

So the simple question here is, should we expect in the near term that expense growth is going to out-pace revenue growth?

Second question, you've come up with your capital management, your guidance. You've highlighted your surplus to 10.5% but clearly the Board will have a buffer around that. Should we be thinking of a different number in terms of your future execution for capital management? Say around 11% or something around there?

So two questions, expense revenue growth jaws and (2) capital management target ratios.

Matt Comyn: Yes, hey, Jarrod. Why don't I start on the first and Alan can take the second? I recognise it's a simple question, unfortunately, I'm not going to give you a simple answer.

Look, there's obviously a combination of factors and just as you've identified, we're constantly evaluating the revenue situation. It's been under pressure for some time. I mean, the volume growth's been very strong this year but in the near-term, yes, net interest margins will continue to be under pressure.

We're going to try and manage that as best we can. Obviously, we're also looking for any opportunities to recover some of that revenue growth. Some of that will come back in the context of post-COVID and lockdown, international spend. Some, obviously, elements of our business that are leveraged to that.

Look, we start the year with a definitive cost plan. We track that very closely with a number of different initiatives but we also want to be able to create flexibility for ourselves. So, if we see opportunities because volume growth's really high and we want to be able to make sure that we're serving our customers delivering very competitive decisioning and turnaround times, we want to be able to pursue that.

If we see others perhaps going in a different direction, it makes it probably more inclined to increase investment. So for us, we're always going to be trying to manage the expenses and deliver the most optimal outcome to - not just in the next, in FY22, obviously that result's important but really, we want to make sure that in FY25 and beyond, we've positioning the Bank for the best overall long-term performance.

Alan Docherty: On the capital levels, I mean, you'll recall a few years ago, Jarrod, we provided I think a fair amount of detail around how we were thinking about capital and the construct of the unquestionably strong capital requirement when those reforms were finalised.

We're awaiting the update to APRA's Basel III capital requirements that we're expecting by the end of this calendar year. You've heard APRA say publicly that they'd expect that as a result of those requirements, it's going to inject more risk sensitivity into the calculation. That's likely to lead across the industry to an aggregate reduction of risk-weighted assets.

The composition of the capital requirements, the buffers, the various elements including the cyclical buffer, all of that will be updated as part of those requirements. So, you can understand, in terms of providing more colour around our approach under those new rules, we want to see the final form of the requirements.

There's been a very good consultation process, very constructive process that APRA have run with the industry that we've participated in. We await the finalisation of those rules and then once we've got the final rules, I think that might be the time to talk more - in more detail about how we think about our capital levels longer term.

Melanie Kirk: That brings us to the end of this briefing. Thank you very much for joining us and we look forward to continuing the engagement. Thank you.

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