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(Via email)

Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir,

INQUIRY INTO THE BANK FUNDING GUARANTEES

We appreciate the opportunity to make a brief submission to the Inquiry into the Bank Funding Guarantees.

The Suncorp Group is a diversified financial services provider with banking, general insurance and wealth management businesses. The Group operates throughout Australia and New Zealand.

Suncorp recognises the importance of the Government's Wholesale Funding Guarantee and associated measures in restoring stability to local financial markets and enabling Australian bank access to international funding markets.

It also believes that there have been some unintended consequences of the Guarantee and that there is an opportunity to address these. The Group's submission (attached) comments on these matters.

Suncorp would be pleased to provide any additional information the Committee might require to assist with its Inquiry.

Yours sincerely

Ron Burke
Executive Manager Group Corporate Affairs

Inquiry into the Bank Funding Guarantees Suncorp Group Submission

Introduction

The introduction of the Wholesale Government Guarantee scheme in October 2008 provided much needed stability to the financial system and allowed Australian banks to effectively raise funds in international markets.

The Guarantee has been utilised extensively over the past 10 months underpinning the ongoing ability of Australian banks to lend.

The pricing approach undertaken by investors, however, has been different to that originally expected. This has resulted in AA rated banks having a significant cost advantage compared with smaller, lower rated banks.

Background

Prior to the global financial crisis, the AA and A rated Australian banks accessed a variety of markets to provide long and short term wholesale funding.

The pre crisis levels were on average:

- In the shorted dated instruments (90 days) Suncorp was issuing on average 5bp over the majors
- On the term side (three years) the spread differential was approximately 5-10bp

As the crisis developed, the AA banks had a significantly greater access to markets to raise funds. For a period, A rated banks were effectively squeezed out of these markets. (The relevance of term wholesale funding for BBB's was minimal given their funding mix).

The implementation of the Government Guarantee scheme enabled A rated banks to once again access international markets. However, the cost differential of doing so was higher than initially anticipated.

It was assumed that a relatively small differential would be applied by investors to guaranteed issues as the ultimate credit was the AAA Commonwealth of Australia. A small premium was expected to reflect potential liquidity differences and other factors.

In practice, investors looked through the Guarantee and applied a full differential to AA and A credits in line with that being applied by the Government for the provision of the Guarantee.

Current Impact

Investors continue to apply a 25-35bp spread differential between AA and A rated banks for Government guaranteed paper.

To give an example of the impact of this: From a total pricing perspective for a three year term deal, with the Guarantee added (a charge of 30bp) – the total cost of funding for single A banks is approximately 55-65bp wider than the AA banks.

In addition, while the non guaranteed market is showing improvement, investor appetite is still significantly lower for single A banks compared to AA.

Current Government Guarantee Levels

	AA	A	BBB
Three year	35bp	55bp	80bs
Five year	50bp	70bp	95bp

Approximate US Mid swaps. (Does not include Government Guarantee fee)

Volumes Issued

AA	A\$69.9 billion
A	A\$22.9 billion
BBB	A\$1.6 billion

(Source: Dealogic)

Recommendations

1. Continue the Wholesale Government Guarantee
 - Accessibility for the AA banks in the non guaranteed market is already apparent both offshore and domestically
 - The ability for single A banks to access the non guaranteed market will take much longer as credit market confidence increases over time
 - It is therefore imperative that removal of the Government Guarantee is based on a holistic approach for all Australian deposit taking institutions (ADI's)
 - It is important that no steps to remove the Guarantee are made until the markets allow efficient issuance for all ADI's that utilise term funding – rather than just large banks

2. Review and Reduce the current fee structure
 - The significant difference between issuance levels for guaranteed AA and A banks is impacting on competition in the market
 - Apply a flat fee for all rated ADI's across all terms of issuance. This would eliminate any fee differential and would compensate all rated ADI's for any investor credit premium applied to term issues