SUNCORP BANK

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Our Ref: DF026_let

Mr John Hawkins
The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
By email: economics.sen@aph.gov.au

Dear Mr Hawkins

Economics Committee: Inquiry into aspects of banking mergers

Thank you for the opportunity to make a submission to the committee on the topic of competition and bank mergers. The terms of reference for this Inquiry are particularly topical due to the confluence of economic, funding and environmental events that have fundamentally changed the operating environment for all banks, more significantly for non-majors. How these events evolve will determine the banking landscape and competition going forward.

The biggest impact on the banking sector has emanated from the credit squeeze which shutdown access to the types of liquid international markets that existed prior to the global financial crisis. There have been significant flow-on effects, even for those banks not accessing wholesale markets. All banks have had to review their portfolios and the emphasis they place on lending in various segments. We've seen aggressive competition for deposits as the alternative funding sources dried up. Meanwhile, the economic downturn has seen an uptick in bad debts which has put pressure on earnings and capital.

Guarantees and cost of funding

The Government deposit guarantee provided much needed reassurance to consumers. And the wholesale funding guarantee once again allowed Australian banks to raise funds in the 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 in our view not been in line with that initially intended, leading to a significant costs advantage for the AA rated banks over the smaller, lower rated banks.

Prior to the financial crisis the AA and A rated Australian banks accessed a range of markets to provide long and short term wholesale funding. The pre crisis levels were on average 5 to 10 basis points higher for Suncorp over the majors for both short and term debt. As the crisis developed, the AA banks had significantly greater access to the markets than the A's and lower-rated banks, with these banks effectively being squeezed out of the market. The implementation of the Guarantee scheme gave A-rated banks access to the markets again, but the cost differential of doing so was higher than initially anticipated. In practice, investors are looking through the guarantee and applying near-to a full differential to AA and A credits in line with that being applied by the government for the provision of the guarantee. Consequently, the total cost of funding for single-A banks is approximately 55 to 65 basis points wider than the AA banks.

The Global Financial Crisis created a cost of funding differential between the majors and all other players that was virtually non-existent two years ago and for at least a decade prior to that. A protracted period of such disparity has the potential to significantly impact competition going forward. This signals the importance of the guarantee. Regional banks should expect to pay more given their lower credit ratings, and this is happening through natural market forces as investors price for risk. But regionals are paying twice, through the guarantee and market pricing. I don't believe this was the Government's intention and regional banks can't afford a double differential. The fee should be level for all banks at the rate paid by the AA banks.

Regional banks

Events of the past two years have changed regional banks. As the largest regional bank, we occupy a unique space between the majors, with their AA ratings and other regional banks which have BBB ratings. We have a larger balance sheet and high credit rating than other regionals but a lower rating than the majors. The shutdown of wholesale markets, on which Australia is so heavily reliant, put the majors in a difficult position but placed us under added pressure.

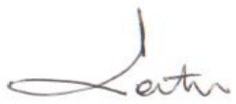
We've responded appropriately. We've had to adapt and drive significant change in the shape of our bank. The bank we operate today is a far different organisation than it was two years or even 12 months ago. This has been driven by a change in funding dynamics, highlighting the criticality of funding in competition.

Mergers and competition

It's in the best interests of consumers and our economy for a robust multi-tiered banking system to exist. The threat right now is that limited access to funding markets and securitisation will restrict the ability of regionals and non-banks to create necessary competitive tension. There are plenty of participants in the market right now but at question is their ability to offer a sustainable competitive proposition. There are a number of options open to Government to support initiatives which open up the market and support competition. These include more funds for the Australian Office of Financial Management which would help non-bank lenders as well as the banks. The Australian Securitisation Forum has written a comprehensive paper on the various options and these have real merit.

Access to funding and thus competition would be supported by flattening the fee on government guaranteed wholesale funding. And importantly, maintaining the scheme for the security of the whole Australian banking system. Investors take a holistic view of Australian financial services and a deterioration in one sector of our banking system will have implications for all banks. It's imperative that eventual removal of the guarantee is based on a view that takes into account all Australian Deposit taking Institutions. 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. The challenge is to look through all the rhetoric and ensure policy supports a competitive and sustainable banking sector for the future.

Yours sincerely



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