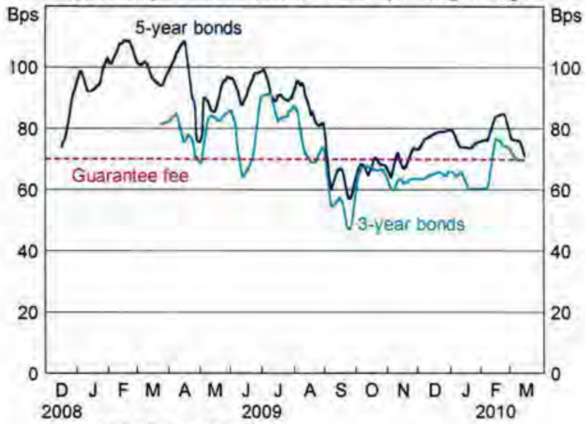
# GOVERNMENT GUARANTEE SCHEME: FEBRUARY 2010 FEE REPORT

To some extent, the recent guaranteed issuance may also reflect an increase in investor demand for guaranteed debt, owing to an anticipated scarcity of this paper when the Scheme closes. Consistent with this, the indicative spread between the major banks' guaranteed and unguaranteed three-year debt widened by around 10 basis points immediately after the announcement, although this has proved short-lived

**Graph 3**
**Major Banks' Domestic Unguaranteed Bonds**
Spread to guaranteed bank bonds, 5-day moving average




Source: UBS AG, Australia Branch

Financial Stability Department
16 March 2010

## HACK, Mark

**From:** HACK, Mark
**Sent:** Tuesday, 23 March 2010 17:32
**To:** EMERY, David
**Cc:** KIRKWOOD, Joshua
**Subject:** Cost of funding residential mortgages [SEC=UNCLASSIFIED]

**Security Classification:** UNCLASSIFIED

Dave,

A graph displaying the relative costs of funding residential mortgages with bonds and RMBS can be found here. Key points to note:

- For the major banks, on-balance (bond) sheet funding is cheaper than securitised funding (by around 30 bps)

Calculations underlying the graph are outlined below.

The cost of **securitised funding** was computed using a simple RMBS structure (which is consistent with recent RMBS issues) wherein:

- Around 90-95 per cent of the RMBS consists of senior AAA-rated notes (issued at a margin of BBSW + 130-135bps);
- Around 2-6 per cent of the RMBS consists of subordinated AAA-rated notes (issued at a margin of BBSW + 175-180bps);
- 1-2 per cent of the RMBS consists of subordinated AA- rated notes (issued at a margin of around BBSW + 230-240bps).

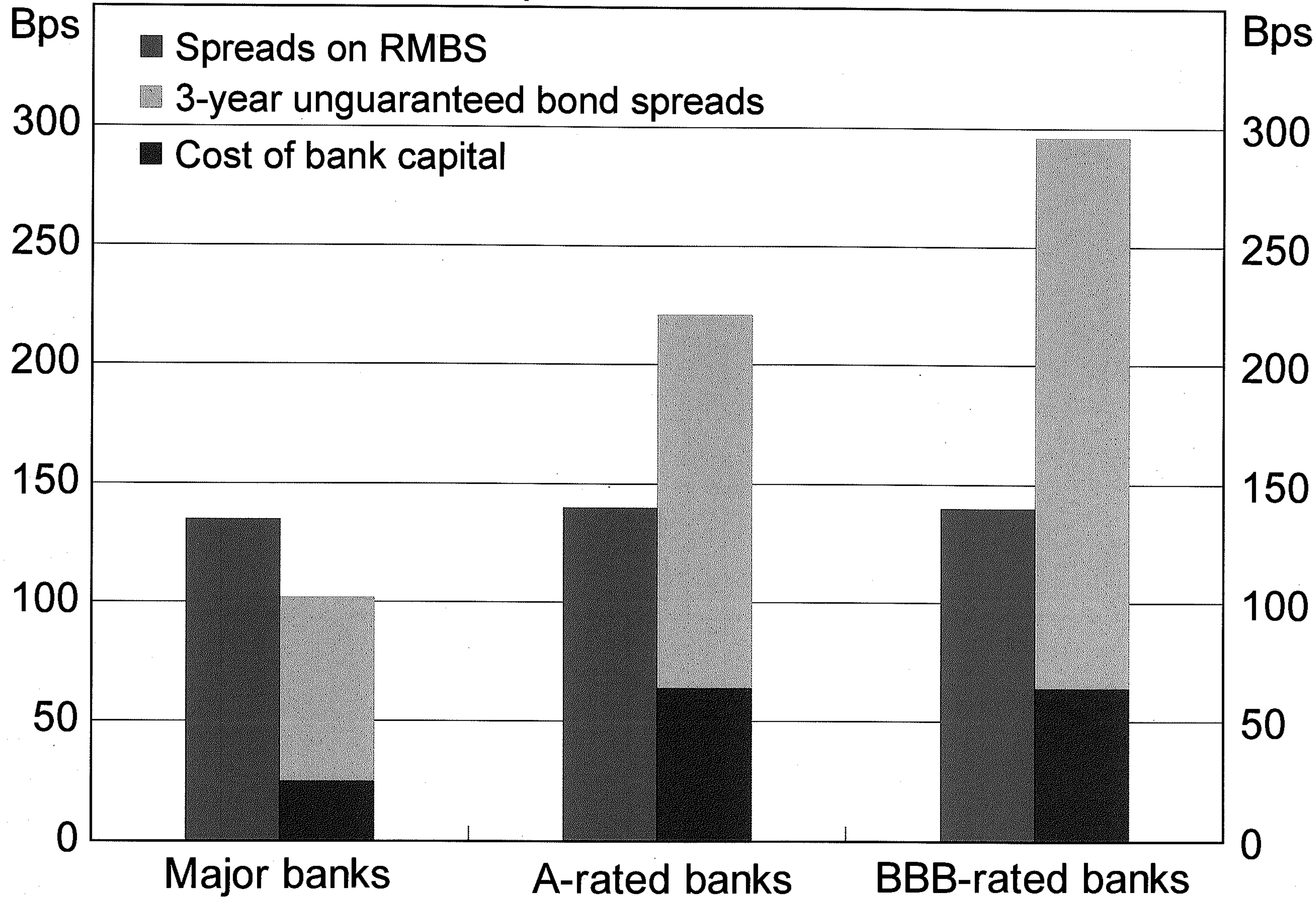
The cost of **on-balance sheet (bond) funding** was computed using an estimate of 3-year unguaranteed bond spreads and an estimate of the 'cost of capital', which was computed by multiplying the cost of equity (which we assume as 15 per cent for the majors, and 20 per cent for both A-rated and BBB-rated banks) by the regulatory capital requirement for 'prime' residential mortgages (which was computed with information that we received from FS - see attached email below).

Some caveats:

- We assume that regulatory capital requirements are met with equity (Tier 1 capital); in practice, ADIs are able to use Tier 2 capital to meet up to 50 per cent of their regulatory capital requirements.
- For securitised funding, we assume the originating banks retain no exposure or implicit support to securitisations (and hence that there are no capital costs incurred in issuing RMBS).
- We ignore alternative on-balance sheet sources of finance (e.g. deposits).

# Cost of Funding Residential Mortgages*

Spread to BBSW




* Excludes deal costs
Source: RBA

Recent RMBS structures:

- Senior AAA-rated tranche, making up 92-96 per cent of the RMBS, for which pricing is always disclosed.
- Subordinated AAA-rated tranche, making up 2-6 per cent of the RMBS, for which pricing is typically disclosed.
- Subordinated AA- rated tranche, making up 1-2 per cent of the RMBS, for which pricing is typically not disclosed.

| | SPREADS | | | WEIGHTS | | | Weighted-average Spreads | | |
|---|---|---|---|---|---|---|---|---|---|
| | Major Banks | A-rated Banks | BBB-rated Banks | Major Banks | A-rated Banks | BBB-rated Banks | Major Banks | A-rated Banks | BBB-rated Banks |
| Senior AAA-rated tranche | 130 | 135 | 135 | 0.92 | 0.92 | 0.92 | 135 | 140 | 140 |
| Subordinated AAA-rated tranche | 175 | 180 | 180 | 0.06 | 0.06 | 0.06 | | | |
| Subordinated AA- rated tranche | 233 | 240 | 240 | 0.02 | 0.02 | 0.02 | | | |

| Securitisation funding costs (spread to BBSW) | | | |
|---|---|---|---|
| | Major Banks | A-rated Banks | BBB-rated Banks |
| Spread on RMBS | 135 | 140 | 140 |
| Deal costs | 50 | 50 | 50 |
| TOTAL | 185 | 190 | 190 |

| Balance sheet funding costs (spread to swap) | | | |
|---|---|---|---|
| | Major Banks | A-rated Banks | BBB-rated Banks |
| Spread on 3-year bonds (unguaranteed) | 0 | 191 | 266 |
| Spread on 3-year bonds (guaranteed) | 70 | 162 | 214 |
| Cost of bank capital | 25 | 64 | 64 |
| Deal costs | 3 | 4 | 4 |
| TOTAL (unguaranteed) | 28 | 259 | 334 |
| TOTAL (guaranteed) | 98 | 230 | 282 |

| | | | |
|---|---|---|---|
| Cost of equity | 15 | 20 | 20 |
| Risk-weight on housing loans | 21% | 40% | 40% |
| Capital ratio | 8% | 8% | 8% |
| **Capital requirement:** | **1.7%** | **3.2%** | **3.2%** |

# Fortnightly Briefing on Lending and Funding

## 4. Bank funding

Spreads on the major banks' bonds trading in the domestic market were broadly unchanged over the past week.

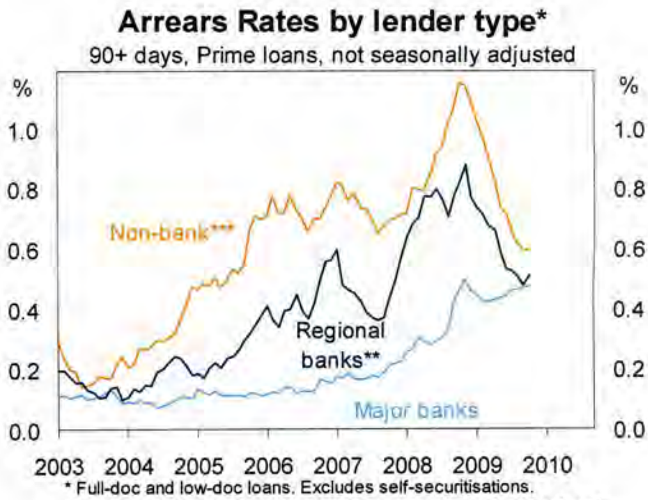
*Reserve Bank of Australia and Australian Prudential Regulation Authority*

*26 March 2010*

# SECURITISED HOUSING LOAN ARREARS – JANUARY 2010

By **lender type**, the 90+ days arrears rate ticked up for both banks and non-banks. The arrears rate for non-banks and regional banks have fallen substantially since their late-2008 peaks (Graph 7). While the arrears rate of the five largest banks did not deteriorate as much as that of non-banks and regional banks over recent years, it continued to rise over 2009 and is now at a similar level to the regional banks.

**Graph 7**




* Full-doc and low-doc loans. Excludes self-securitisations.
** Includes Adelaide Bank, Bank of Queensland, Bendigo Bank and Suncorp-Metway
*** Includes Macquarie Securitisation.
Sources: Perpetual; RBA

Rob Johnson
Financial Stability Department
31 March 2010

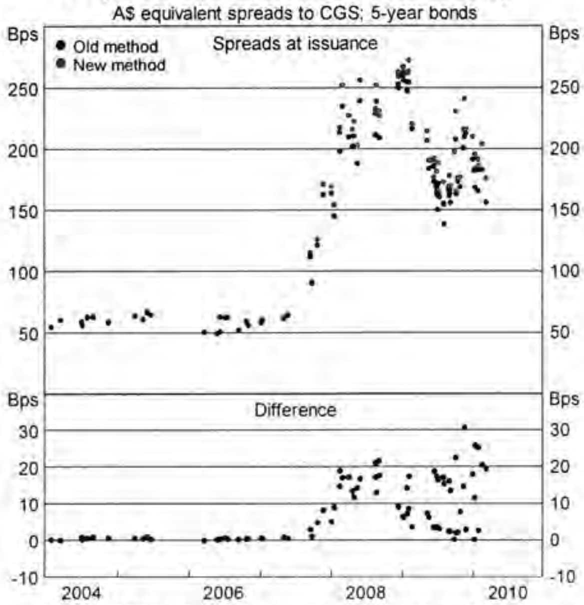
# COMPUTING HEDGED SPREADS OF FOREIGN CURRENCY BONDS

The effect of accounting for additional hedging costs is negligible prior to the onset of the crisis. Since June 2007, however, these additional costs have added an average of 11 basis points to the major banks' hedged spread (Graph 2).

**Graph 2**

**Major Banks' non-AUD Bond Pricing***

A$ equivalent spreads to CGS; 5-year bonds




* Issues >A$100 million only. Government guaranteed bonds include the 70bps fee.
Source: RBA

Mark Hack
Securities Market Section
Domestic Markets Department
1 April 2010

# DOMESTIC MARKETS REVIEW: APRIL 2010

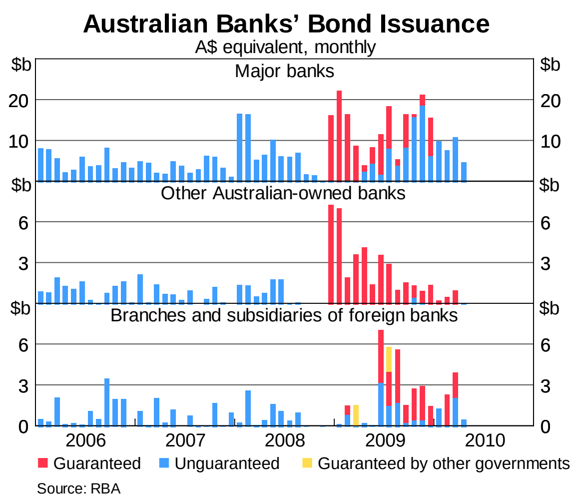
## Summary

- Secondary market spreads on major banks' unguaranteed and guaranteed bonds remained broadly unchanged this month.

- We estimate that the major banks' outstanding net interest margin widened a little over the month, as average lending rates increased by more than average funding costs.

# NON-INTERMEDIATED MARKETS

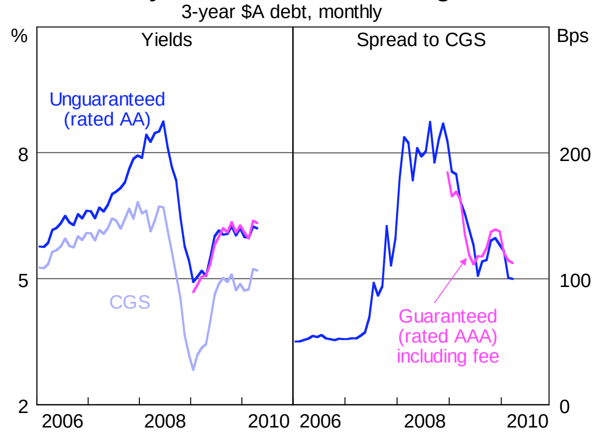
Around half of this month's issuance has been onshore, with the major banks accounting for the bulk of overall issuance. Westpac issued the largest deal so far in April, a 3-year $1.75 billion domestic issue. The bond priced at a spread of 101 basis points over CGS, in line with a similar 3-year domestic benchmark deal by NAB in March.




The bulk of the limited offshore issuance in April has been denominated in currencies other than the USD. CBA issued a 5-year £500 million bond (which priced at a hedged spread of 191 basis points over CGS) and a 10-year C$400 million bond (which priced at 212 basis points over CGS). Additionally, Westpac priced a 1½ year US$533 million bond at 18 basis

**Major Banks' Bond Pricing**

3-year $A debt, monthly

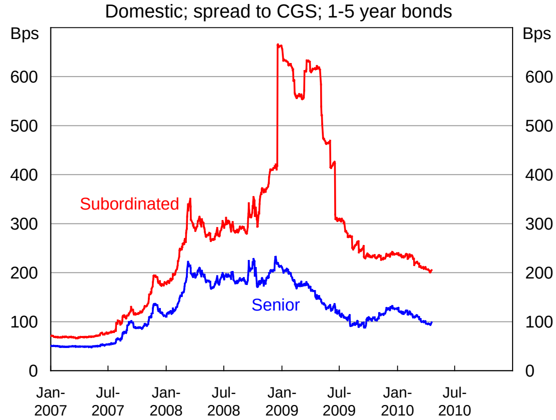



Sources: RBA; UBS AG, Australia Branch

Spreads on major banks' 3-year unguaranteed bonds trading in the domestic secondary market remain little changed since end-March, at around 100 basis points over CGS. Guaranteed spreads are also little changed during April (at around 115 basis points, including the fee), and remain 15 basis points below their level prior to the announcement that the Guarantee Scheme will be withdrawn. With CGS yields falling slightly in April, yields on major banks' 3-year bonds have declined marginally, to 6.20 per cent for unguaranteed bonds and 6.35 per cent for guaranteed bonds (including the fee).

**Major Banks' Unguaranteed Bond Spreads**

Domestic; spread to CGS; 1-5 year bonds

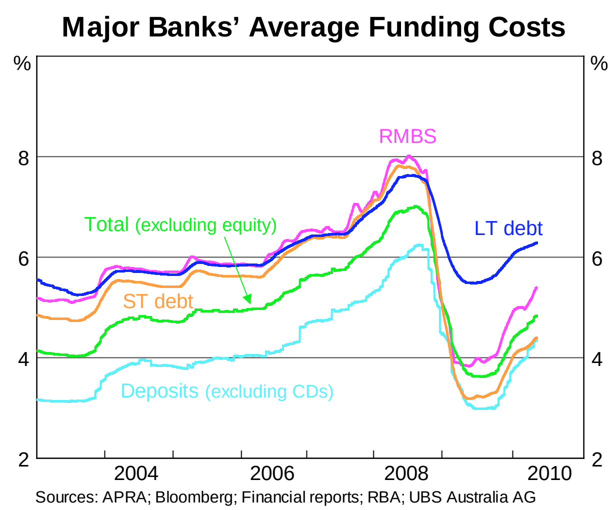



Source: UBS AG, Australia Branch

Spreads on the major banks' domestically-issued subordinated bonds have tightened slightly since the end of March, to around 200 basis points over CGS (their lowest level since February 2008)

# INTERMEDIATED MARKETS

The major banks' average funding cost is estimated to have increased by 13 basis points since end March. This was driven by a 15 basis point increase in the cost of both deposits and short-term debt, while the cost of long-term debt increased by only 5 basis points.



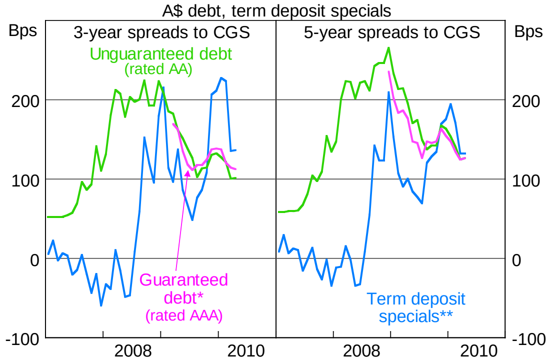

## Banks' Net Interest Margin

We estimate that the *major banks'* net interest margin (NIM) on their outstanding interest-earning assets and liabilities has increased by about 5 basis points since end March.

The major banks also continue to offer higher rates on term deposits with longer tenors relative to the rates on bonds of equivalent maturities (particularly at the 3-year maturity), although the gap has narrowed recently.

**Major Banks' Pricing of Term Deposits and Bonds**

A$ debt, term deposit specials




* Includes fee for guaranteed issues
** Prior to September 2008 it is the 24-month spread
Sources:Bloomberg; RBA; Thomson Reuters; UBS AG, Australia Branch

# Fortnightly Briefing on Lending and Funding

## 4. Bank funding

- Spreads on the major banks' unguaranteed bonds trading in the domestic market tightened by around 10 basis points over the past fortnight, to 100 basis points. Guaranteed spreads tightened around 5 basis points after the closure of the Guarantee.

*Reserve Bank of Australia and Australian Prudential Regulation Authority*

*9 April 2010*

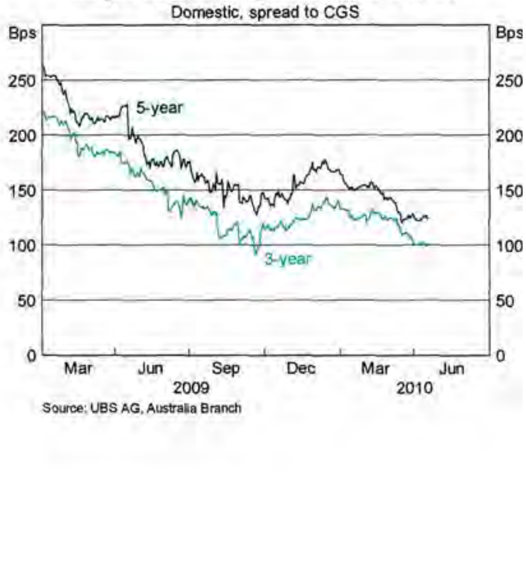
# GOVERNMENT GUARANTEE SCHEME: MARCH 2010 FEE REPORT

Banks' access to long-term wholesale debt funding appears to have been unencumbered by the closure of the Scheme. Issuance has totalled $5.2 billion in April to date, and has taken place at lower risk spreads than those generally prevailing in the first quarter of 2010 (Graphs 2 and 3). Issuers have mostly been rated AA- or above, though Bank of Scotland, which is rated A+, raised $500 million at two years.

**Graph 3**

**Major Banks' Unguaranteed Bonds**

Domestic, spread to CGS




Source: UBS AG, Australia Branch

Financial Stability Department
20 April 2010

# Fortnightly Briefing on Lending and Funding

## 4. Bank funding

Spreads on the major banks' unguaranteed 3-year bonds trading in the domestic market have tightened slightly during the fortnight, to 97 basis points, while guaranteed spreads have widened slightly.

*Reserve Bank of Australia and Australian Prudential Regulation Authority*

*23 April 2010*

# ANZ 2010 HALF-YEAR PROFIT RESULTS

## Net interest income

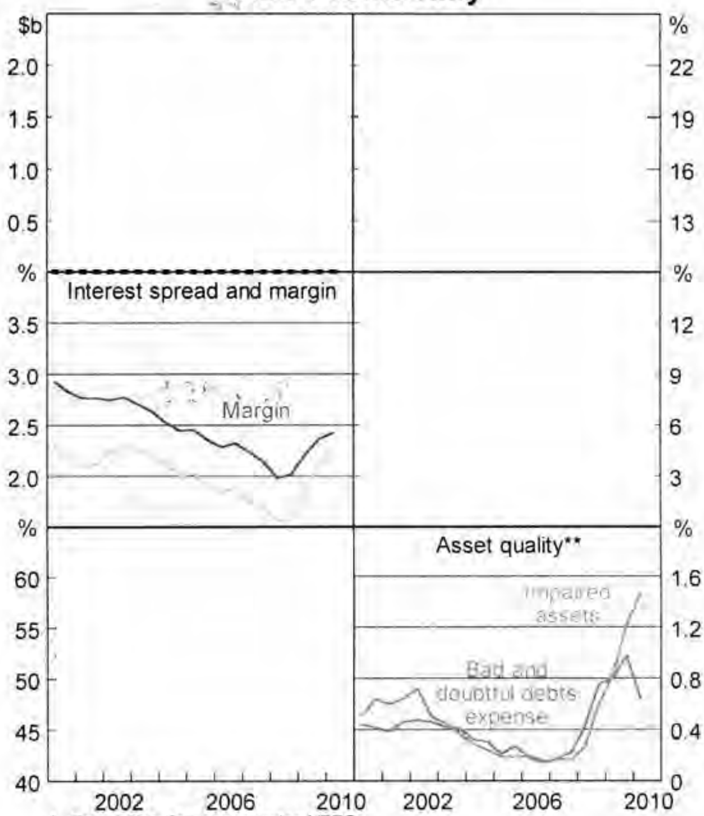
Net interest income rose by 8 per cent, to $5.2 billion, driven by a 21 basis point increase in the net interest margin (NIM). The increase in the NIM reflects a 15 basis point increase over the six months to September 2009, and a further 6 basis points increase over the latest six months; the NIM for the consolidated group was 2.43 per cent over the latest six months. The increase from March 2009 was driven primarily by improved asset margins (48 basis points) and by changes in the composition in assets and funding (21 basis points). These increases were partly offset by the effect of higher costs of deposits (-19 basis points) and other funding (-18 basis points) and by the activities of the Markets division (-11 basis points).

**ANZ 2010 Half-Year Profit Results**

| | Underlying* | | Headline | |
|---|---|---|---|---|
| | $b | Growth** | $b | Growth** |
| Bad and doubtful debts | 1.1 | (21) | 1.1 | (21) |

* Excluding significant items
** Year-on-year percentage change

**ANZ's Profitability***




* From 2006, figures are under AIFRS.
** Expressed as a percentage of net loans.

**Asset quality**

The bad and doubtful debts expense was $1.1 billion; a fall of 21 per cent from the same period last year. As a percentage of net loans and advances, the bad and doubtful debts expense fell by 16 basis points to 0.65 per cent. Reflecting the fall in bad and doubtful debt expense, the growth in the stock of provisions on the balance sheet was slower than in previous periods. Specific provisions increased by 19 per cent, to $1.6 billion, and collective provisions increased by 11 per cent, to $3 billion, from the March 2009 half-year.

**Capital and Funding**

ANZ's Tier 1 capital ratio was relatively stable in the latest half-year, following an increase of 2.4 percentage points over the half-year to September 2009. ANZ noted that, under the UK FSA's capital adequacy requirements, it would report a Tier 1 capital ratio of 13.5 per cent.

ANZ has continued to increase the proportion of funding that comes from deposits (up 2 percentage points to 56 per cent) and long-term wholesale debt (up 2 percentage points to 17 per cent). The share of funding that comes from short-term wholesale debt declined by 4 percentage points to 14 per cent. ANZ has completed 70 per cent of its term funding requirement for the 2010 financial year.

Anna Brown
Institutional Markets Section
Domestic Markets Department
29 April 2010

## DOMESTIC MARKETS REVIEW: MAY 2010

### Summary

- Secondary market spreads on major banks' unguaranteed & guaranteed bonds were stable until the concerns over Greece saw them widen by around 10-15 basis points.

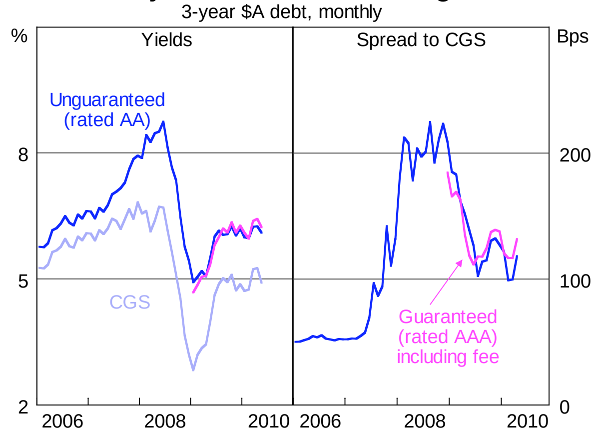
- The major banks' combined underlying (after-tax) profit for the first half of 2010 was $10.2 billion, 17 per cent higher than in the same period last year. The increase was largely driven by a fall in the banks' bad and doubtful debts expenses and an increase in net interest margins.

- We estimate that the major banks' outstanding net interest margin widened a little over the month, as average lending rates increased by more than average funding costs.

# NON-INTERMEDIATED MARKETS

**Major Banks' Bond Pricing**

3-year $A debt, monthly

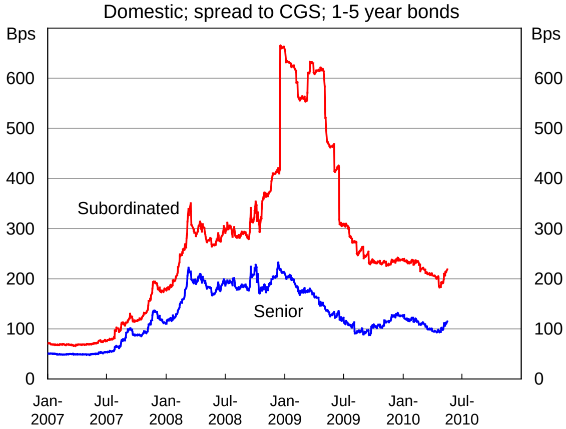



Sources: RBA; UBS AG, Australia Branch

Spreads on major banks' 3-year unguaranteed bonds trading in the domestic secondary market widened, by about 10 basis points earlier this month, to around 119 basis points over CGS. The movement coincided with the movements in Greek sovereign spreads (both bonds and CDS), reflecting risk aversion and concern about the potential for contagion within and beyond the euro area. Until this widening, spreads had been relatively stable.

**Major Banks' Unguaranteed Bond Spreads**

Domestic; spread to CGS; 1-5 year bonds

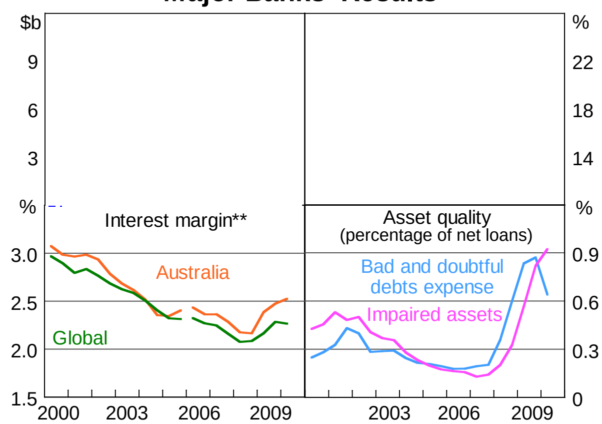



Source: UBS AG, Australia Branch

Spreads on the major banks' domestically-issued subordinated bonds have widened by about 26 basis points since the end of April, to around 219 basis points over CGS.

# INTERMEDIATED MARKETS

**Major Banks' Results***




* From 2006, figures are under AIFRS
** Four largest banks prior to the first half of 2009
Sources: Banks' financial reports; RBA

## Bank Half-Year Profit Results

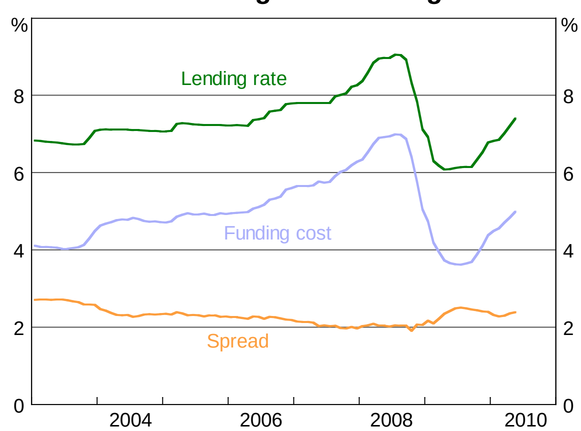
The banks' profits were underpinned by solid results from their Australian operations, while their overseas operations generally recorded lower profits. Net interest income increased by 12 per cent to $23 billion, largely driven by a 13 basis point rise in group NIMs and modest growth in average interest earning assets. On average, the major banks' group NIMs are now about 11 basis points higher than they were in mid-2007, while their Australian NIMs are 24 basis points higher.

Consistent with some of the commentary from the major banks in late 2009, bad and doubtful debt (BDD) expenses appear to have peaked in the half-year ending September 2009. As a share of net loans and advances, the BDD expense has fallen from 0.87 per cent to 0.64 per cent over the two most recent half years. This largely reflected a fall in new specific provisions on business loans, as well as higher-than-expected recoveries on loans against which provisions had already been raised. The decline in the BDD expense was less pronounced for NAB than the other major banks.

## Banks' Net Interest Margin

We estimate that the *major banks'* net interest margin (NIM) on their outstanding interest-earning assets and liabilities has increased by 6 basis points since end April, to 242 basis points.

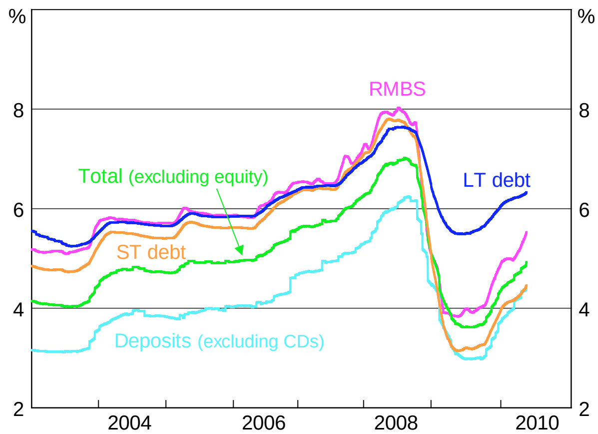
**Average Rates on Major Banks' Outstanding Lending and Funding**




Sources: APRA; Bloomberg; Financial reports; RBA; UBS AG, Australia Branch

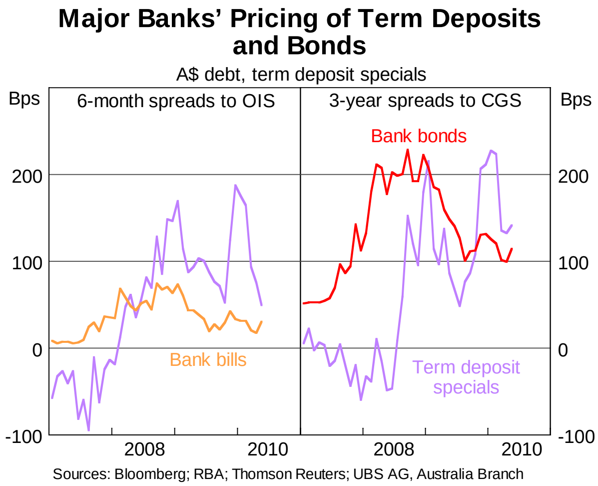
The major banks' average funding cost is estimated to have increased by 15 basis points since end April. The increase was attributable to a 24 basis point increase in the cost of short-term debt, and smaller increases in the costs of deposits (13 basis points) and long-term debt (10 basis points).

**Major Banks' Average Funding Costs**




Sources: APRA; Bloomberg; Financial reports; RBA; UBS Australia AG

The major banks continue to offer higher rates on term deposits with longer tenors relative to the rates on bonds of equivalent maturities (particularly at the 3-year maturity).



# WESTPAC MARCH 2010 HALF-YEAR PROFIT RESULT[1]

## Net interest income

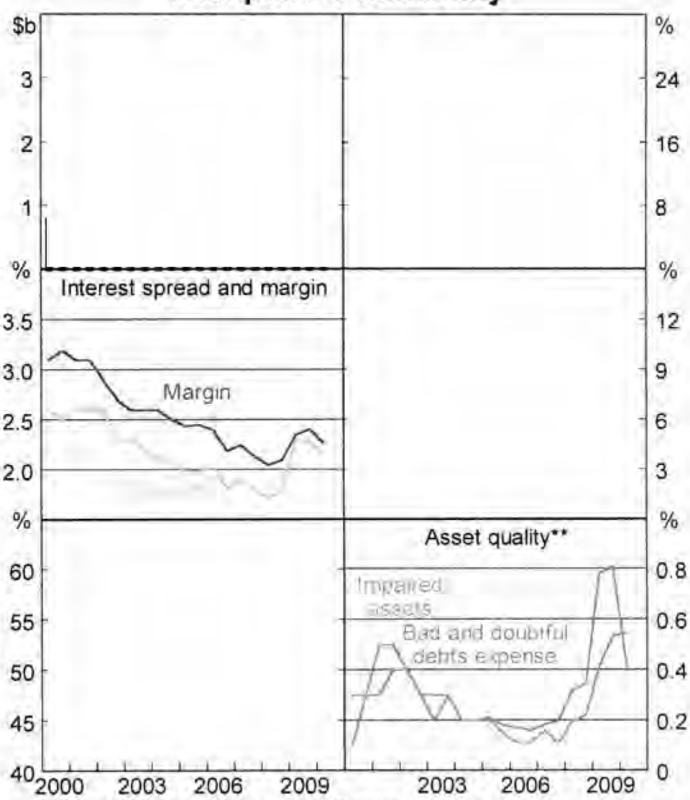
**Westpac 2010 Half-Year Profit Results**

| | Underlying* | | Headline | |
|---|---|---|---|---|
| | $b | Growth** | $b | Growth** |
| Bad and doubtful debts | 0.9 | (45) | 0.9 | (45) |

* Excluding significant items
** Year-ended change between pro-forma 1H09 and reported 1H10 figures.

The underlying NIM over the March 2010 half-year was 2.27 per cent, an increase of 3 basis points relative to the March 2009 half-year. Over the most recent six months, however, there was a 14 basis point decrease in the NIM (compared to an 18 basis point increase in the prior half year). The large movements in the NIM in the two halves were driven by changes in margins for the Group Treasury. "Institutional lending, markets and other" contributed an additional 10 basis points to the NIM, more than offsetting an 8 basis point decline attributable to consumer and business loans margins (resulting from higher funding costs and changes to the compositions of their assets and liabilities).

**Westpac's Profitability***




* From 2006, figures are under AIFRS; includes St George from 17 November 2008
** Expressed as a percentage of net loans.

**Asset quality**

The bad and doubtful debts expense fell by 45 per cent from the previous corresponding period to $0.9 billion. As a percentage of net loans, the charge for bad and doubtful debts declined by 40 basis points to 0.4 per cent. The decline was driven by lower charges associated with specific provisions for institutional and corporate borrowers. This decline, in turn, reflected both a decrease in the value of loans requiring new provisions and higher levels of write-backs and recoveries on those loans that had already been provisioned against. New charges for general provisions for Australian and New Zealand businesses were also lower.

Westpac was able to reduce their bad and doubtful debt expenses as "stressed" loan exposures appear to have stabilised over the first half of 2010.[2] Around 15 per cent of Westpac's commercial property loan book is classified as "stressed", predominantly reflecting large commercial property loans for development purposes (of which around 40 per cent are "stressed").

**Funding and Capital**

Westpac's proportion of deposit funding was up 2 percentage points over the year to March 2010 to 60 per cent, with growth in term deposits partially offset by a decline in at-call deposits. There has also been a lengthening in the maturity of Westpac's debt, with the share of funding from long-term debt up 4 percentage points to 19 per cent, while the share of short-term debt declined to 21 per cent.

Westpac's Tier 1 capital ratio rose by 53 basis points to 8.64 per cent over the half-year to March 2010. The aggregate capital adequacy ratio was 10.8 per cent as of March 2010.

Arlene Wong
Institutional Markets Section
Domestic Markets Department
4 May 2010

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[2] Westpac defines "stressed" exposures as those exposures that are on a 'watch-list', classified as 'sub-standard', and are more than 90 days past due or otherwise impaired.

# NAB MARCH 2010 HALF-YEAR PROFIT RESULTS[1]

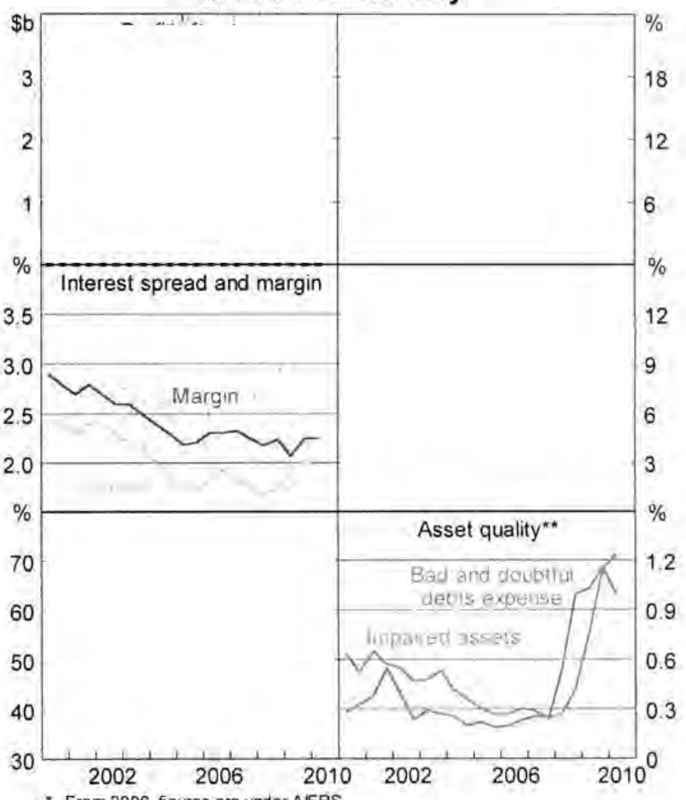
## Net interest income

**NAB 2010 Half-Year Profit Results**

| | Underlying* | | Headline | |
|---|---|---|---|---|
| | $b | Growth** | $b | Growth** |
| Bad and doubtful debts | 1.7 | (5) | 1.7 | (5) |

* Excluding significant items
** Year-on-year percentage change

**NAB's Profitability***




* From 2006, figures are under AIFRS.
** Expressed as a percentage of net loans.

The Group NIM over the March 2010 half-year was 2.25 per cent, an increase of 18 basis points relative to the March 2009 half-year. Almost all of the increase in the NIM occurred over the September 2009 half-year. Higher margins in the business and wholesale banking divisions made the largest contributions. Personal banking and NZ banking made small negative contributions. The Australian NIM increased to 2.50 per cent, 29 basis points higher than in the March 2009 half-year.

**Asset quality**

NAB's charge for bad and doubtful debts fell during the March 2010 half-year to $1.7 billion. This was 14 per cent lower than the prior six months, and 5 per cent lower than the March 2009 half-year. As a percentage of net loans and advances, the charge for bad and doubtful debts decreased by 3 basis points to 1 per cent. The decline was driven by lower charges associated with specific provisions within NAB's Business Banking. New charges for general provisions were also lower.

As a share of net loans and advances, NAB's impaired assets rose by 49 basis points to 1.2 per cent. However, the rate of increase in impaired assets slowed during the half-year to March 2010.

**Funding**

NAB increased the proportion of funding from deposits by 3 percentage points over the year to 54 per cent, with growth in term deposits partially offsetting a decline in at-call deposits. NAB has now completed over half of its 2010 funding target. In its interim report, NAB noted that it would continue to lengthen the maturity of its debt issuance. Total liquid assets were at $68 billion, in line with its March 2009 level.

NAB's Tier 1 capital ratio was 9.09 per cent, up 78 basis points from a year earlier. The aggregate capital adequacy ratio was 12.07 per cent as of March 2010.

Arlene Wong
Institutional Markets Section
Domestic Markets Department
6 May 2010

**Fortnightly Briefing on Lending and Funding**

## 4. Bank funding

Spreads on the major banks' guaranteed and unguaranteed 3-year bonds trading in the domestic market have widened by about 10 basis points during the fortnight.

*Reserve Bank of Australia and Australian Prudential Regulation Authority*

*7 May 2010*

**BANKS' COMMERCIAL PROPERTY LENDING & ASSET QUALITY – MARCH 2010[1]**

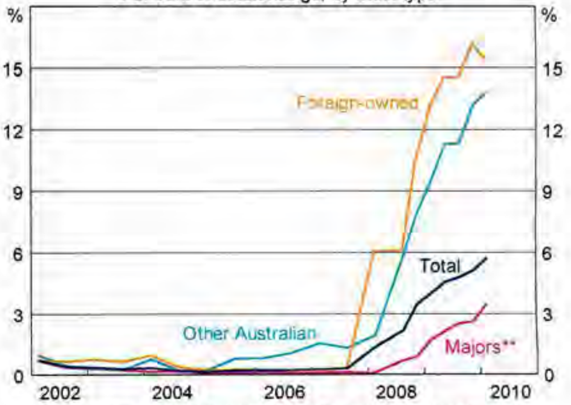
**Asset quality**

By **bank type**, the impaired assets ratio of the major banks rose the most over the quarter, reaching 3.5 per cent from 2.7 per cent at December 2009 (Graph 9). This rise was driven by the broad-based increase in impaired assets held by banks in this category. In aggregate, impaired assets held by the major banks rose by 33 per cent over the quarter.

**Graph 9**

**Australian Commercial Property Impaired Assets**

Per cent of outstandings, by bank type*




* Consolidated, Australian operations; matched sample of 26 banks; figures for March 2010 are preliminary estimates.
** Includes St George, and Bankwest from March 2009.
Sources: APRA; RBA

Consistent with changes in impaired assets held, provisions for (individually identified) expected losses rose for the major banks, and fell among foreign-owned banks. The magnitudes of these changes in **specific provisions** were less than those in impairments; as a result the ratio of specific provisions to exposures rose by only 2 basis points to stand at 1.68 per cent of exposures, or $3 billion This is up from 0.9 per cent of exposures, or $1.8 billion, at March 2009. Specific provisions for other Australian-owned banks rose only very slightly over the quarter, in line with impaired assets at these institutions.

For the five large banks that have **overseas commercial property** exposures, the impaired assets ratio rose to 3.8 per cent over the quarter, from 3.2 per cent at December 2009

Specific provisions rose in line with overseas impaired assets, resulting in a specific provisions ratio for overseas commercial property exposures of slightly more than 1 per cent as at March 2010.

David Rodgers
Financial Stability Department
20 May 2010