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The Future of Australian Bank Funding Report released by the Australian Centre for Financial Studies (ACFS) and KPMG identifies many issues for banks and government in relation to bank funding and questions the sustainability of current funding models of the major banks.

Bank funding models are unlikely to substantially change and regulatory intervention will make little difference, according to the Report.

The ACFS/KPMG Report examines the difference in funding patterns between major and second tier banks and the heavy reliance of the major Australian banks, in particular on wholesale funding, much of it from overseas.

Future options for bank funding structure are limited by two main factors: the ongoing national balance of payments position, with the banks being a main conduit for financing the current account deficit, and the significant ongoing flow of household savings into superannuation funds.

Currently the major banks effectively fund Australia's large and longstanding balance of payments current account deficit by borrowing offshore, and, then lending on-balance sheet to Australian companies.

Detailed analysis of the true cost of funding Australian mortgages is difficult given the geographical and operational diversity of the major banks, but the Australian banking system is exposed to several features that influence perceptions of risk. These relate to the heavy reliance of banks on wholesale funding, the domination of the four majors with similar funding patterns and a relatively high reliance on residential property as an asset class.

The ACFS/KPMG Report draws attention to the relative tax disadvantage of deposits compared to superannuation as a further factor affecting bank funding. Professor Deborah Ralston, Director of ACFS, notes that "as the Henry Review identified, there is a considerable discrepancy in the tax incentives accorded to different forms of saving. As a consequence, this leads to some distortion in personal savings patterns and makes it more difficult for banks to increase the proportion of retail funding sources."

The report acknowledges that the management of funding risk is now a fundamental part of planning and risk management for banks, and finding new ways to diversify funding sources is a key focus.

The report also suggests that given the need for banks to meet new net stable funding (NSF) ratio requirements, use of covered bonds as a stable funding source is an attractive proposition, which may help recycle household savings via superannuation funds back to the banking sector.

ACFS Research Director, Professor Kevin Davis added "While Australian banks weathered the recent Global Financial Crisis with distinction the international liquidity drain during the GFC highlighted the reliance of our banks on offshore funding. Given that the taxpayer was required to support our banks at that time it is important that lessons from that time are well learnt."

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About the ACFS-KPMG Monograph *The Future of Bank Funding*.

The Australian Centre for Financial Studies (ACFS) and KPMG are pleased to publish the ACFS-KPMG Monograph *The Future of Bank Funding* and see this type of research as central to the mission of both firms. The monograph is the first outcome from a research partnership between ACFS and KPMG.

ACFS and KPMG gratefully acknowledge the industry participants who so obligingly contributed their time and thoughts to this monograph.

Copies of the report are available from the ACFS website www.australiancentre.com.au.

About ACFS

The Australian Centre for Financial Studies (ACFS) facilitates industry-relevant and rigorous research and consulting, thought leadership and independent commentary. Drawing on expertise from academia, industry and government, the Centre promotes excellence in financial services. The Centre specialises in leading edge finance and investment research, aiming to boost the global credentials of Australia's finance industry; bridging the gap between research and industry and supporting Australia and Melbourne as an international centre for finance practice, research and education.

The Centre provides access to and links between academics, finance practitioners and government and draws on expertise and experience from across these groups, to facilitate knowledge creation and transfer. ACFS (previously known as the Melbourne Centre for Financial Studies) is a not-for-profit consortium of Monash University, the University of Melbourne, RMIT University and Finsia having commenced in 2005 with seed funding from the Victorian Government. Across the consortium partners ACFS has links with over 100 finance academics and over 200 postgraduate students engaged in finance research.

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