Realm Market Review – Bank Treasures Open their Books

22nd March 2013

At a recent industry conference, the treasures of the 4 major banks gave their insights and views of the funding market. Following is a summary of the collective views from the conference.

TIER ONE HYBRIDS

They see the Tier 1 retail market as the cheapest capital on the planet. Compared to offshore Tier 1 where the market demand is approx. 2.5 the domestic spread. Feel is that under the current environment T1 spreads as tight as they see them going.

TIER TWO DEBT

The Tier 2 market (lower T2) is dead, as there is no market for the new rules. Spread is too tight for retail and not wide enough for wholesale (when pricing for the new Bail in rules). The new T2 rules (Bail in) are too harsh for wholesale and it will take time for a market to develop for issuance to return in this part of a bank's capital structure. One of the treasurers indicated that it (the lower T2 market) most likely would return as a convertible market.

TERM DEPOSITS

They do not see deposit rates coming down soon and it's rather a unique set of circumstances in Australia as compared to the rest of the world.

The internal modelling of the balance sheets are that they view a 3 month deposit like a 3 year senior unsecured, from a rollover perspective. They do not model the contractual risk. The run off assumptions show that on average a depositor stays for about three years. There is a difference between the contractual entitlement and the behaviour.

ON LCR

The LCR definitions are not clear on what is an operational account, what is a financial insto, what is a good deposit, what is a bad deposit etc. What was clear is that once these definitions are defined, they will comply. They also noted that they are all well capitalised.

Banks are on the RMBS trade for CLF (The RBA's Committed Liquidity Facility), as by the time the new capital ratios are implemented the sum would have run off. The banking sector does not believe that the final capital charge for RMBS used in LCR will be as high initially proposed.

APRA will finalise their review on LCR very soon to give the industry some guidance. It is expected no change to the "liquidity view" will arise, however the focus will be on the capital charge.

RMBS & COVERED BONDS

RMBS market still a bank buyers' market domestically. 40% of the issuance is going offshore – to ASIA as part of the carry trade. As covered bond spreads have tightened, it pushed those buyers into the RMBS space. This coupled with the recent BIS announcement of the revised LCR settings saw a step up in demand.

Spreads between cover bonds and senior as too wide given there is only a once notch ratings uplift for Australian banks vs. European banks where a several notch ratings difference exists and the spread is tighter.

A noticeable change is the step up in Q&A from global investors around the T&Cs of issuance now, and what the regulator is asking to be inserted into document.

GLOBAL

The Cyprus situation is serious enough to have an effect here.

Swap costs are high and staying high; particularly given the collateral rules are designed around having a AA- bank as a counterparty – not many left.

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