ING DIRECT
It's your money

Tuesday 30 March, 2010

Bank funding shift hurts second tier lenders

A review of bank funding by Australia's 5th largest retail bank has revealed second tier banks are facing a long term structural disadvantage compared to the big 4.

The ING DIRECT review shows that true banking competition is being held back due to second tier banks facing higher funding costs and lower margins on home lending.

ING DIRECT Chief Financial Officer, Mark Mullington says the disadvantage facing second tier banks is being exacerbated by the national shortfall in savings.

"The shortfall in savings and reliance on securitisation means second tier banks are at clear disadvantage to the big 4," said Mr. Mullington.

"Since the global credit crisis second tier banks are paying relatively more for funding than the big 4 and the longer term trend is for this imbalance to continue." (graphs 1 and 2)

The ING DIRECT review of funding revealed:

- The big 4 have a structural and cost of funding advantage over smaller competitors
- The immediate cost of funding has stabilised but at a much higher rate than pre GFC
- The longer term cost of funding still rising due to portfolio refunding
- Margins on mortgage lending are higher than pre GFC but declining
- Lending Margins for 2nd tier banks lower than the big 4 (graph 3)

The ING DIRECT review of bank funding shows the total Australian saving pool represents just 34% of funding needed for housing and business. (graph 4)

Mr Mullington says while there are promising signs in the securitisation market, current pricing is not profitable. (graph 5)

"There is a structural problem in the Australian banking system that needs fundamental reform," he said.

The funding problem come as Australian banks scramble amongst each other for savings with some paying unsustainable rates to attract funds.

"Basically you have banks fighting for savings from a pool that is simply too shallow," Mr Mullington said.

Mr Mullington said increasing the size of the savings pool is critical to restoring competition in the Australian banking market.

"Basically the war for savings is unwinnable," Mr Mullington said.

ING DIRECT has been a long term supporting of a tax incentive for savings. The Australian taxation system rewards negative gearing into property and shares and superannuation but taxes savings at an individual's highest rate of taxation.

"We have seen tax incentives on savings work in many other countries including the UK, France, the Netherlands and Canada and it would work here," Mr Mullington said.

Improvements to consider:

- removal of withholding tax on money moved from related businesses offshore
- introduction of covered bonds
- introduction of a tax break on savings

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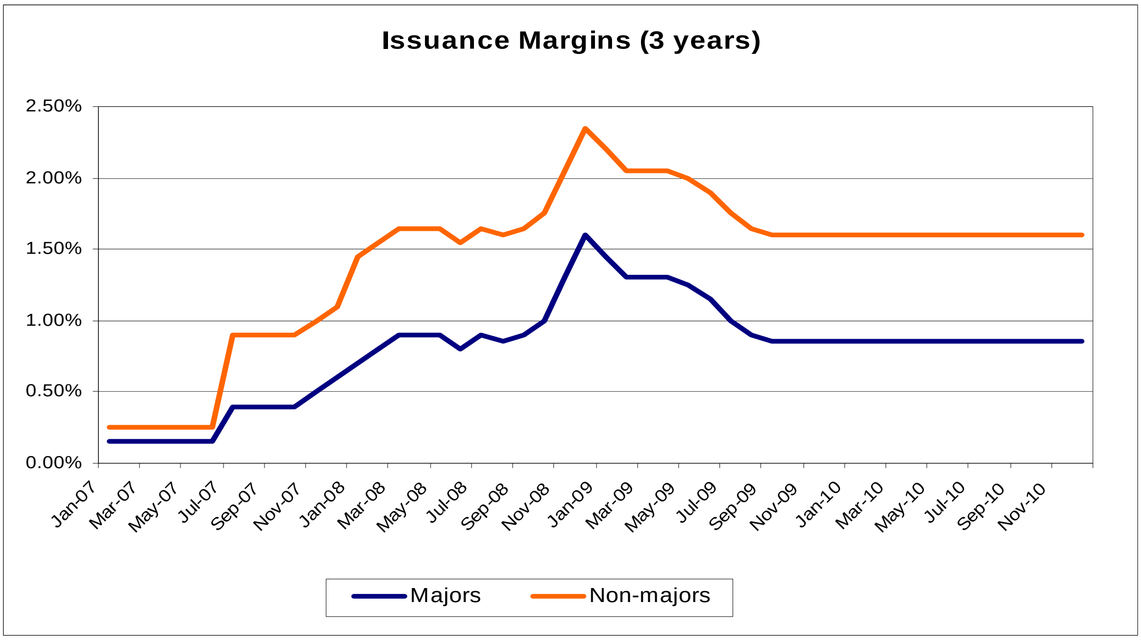
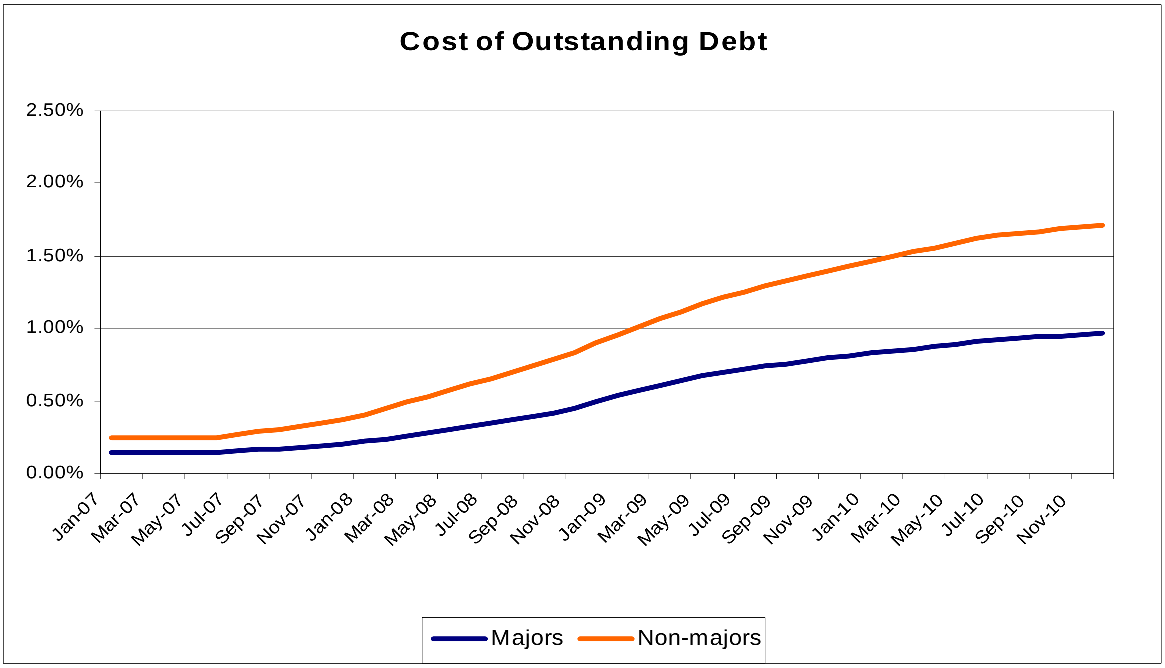
About ING DIRECT
ING DIRECT began operating in Australia in 1999. By doing business online, over the phone and through intermediaries, ING DIRECT keeps it overheads low and passes the savings onto customers in the form of competitive rates. Today, it has grown to become Australia's fifth largest retail bank, with $21 billion in deposits, more than $37 billion in loans and around 1.4 million customers.

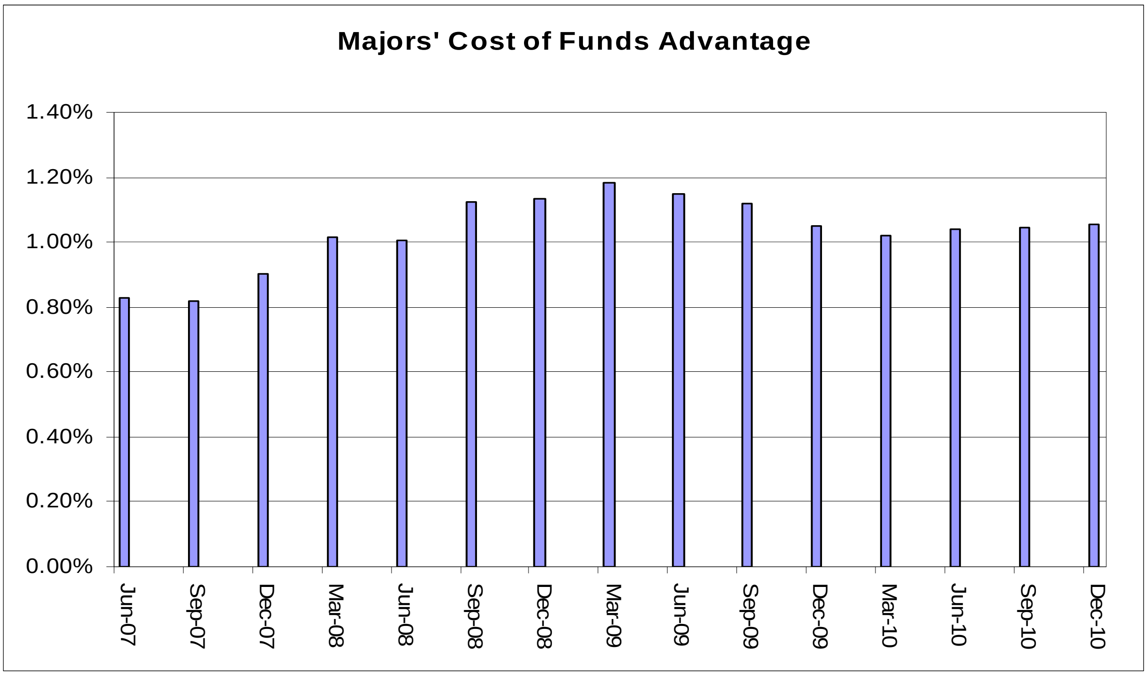
Graph 1



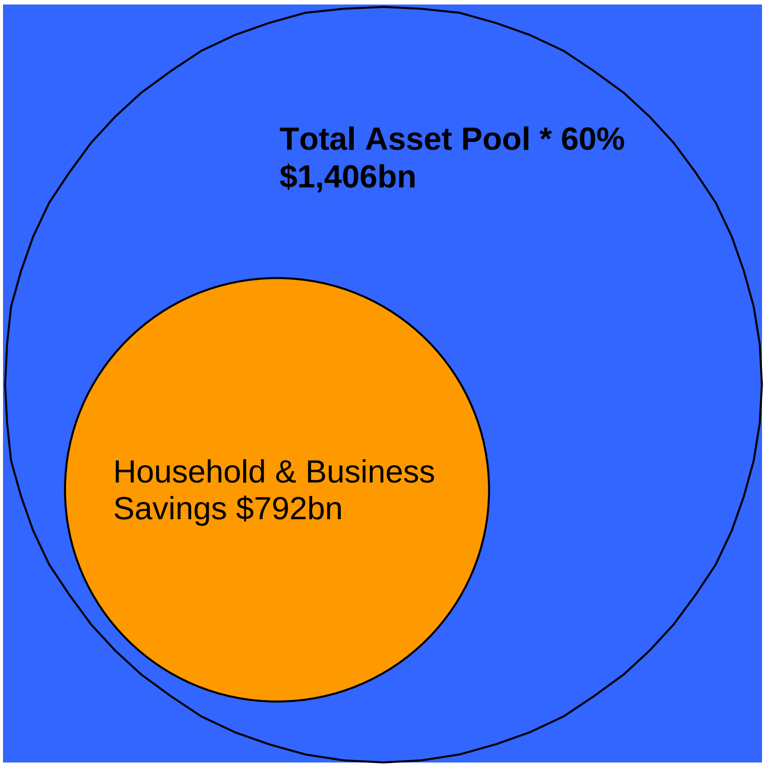
Graph 2



Graph 3



Graph 4
The unwinnable war for savings



- Household and business savings fund only 34% of total resident assets (APRA December 2009)
- Aggressive competition for deposits since the onset of the GFC
- Little impact on the total savings pool – especially while tax system favours superannuation and housing

Graph 5
RMBS to the rescue

AAA tranche coupon	1.30%
All up coupon including subordinated	1.40%
Fees and servicing costs	0.40%
Pool insurance	0.10%
Cash to bills spread	0.30%
Cost over cash	**2.20%**
Basic variable mortgage margin over cash	2.20%
Margin before overheads, marketing, ROE	**$nil**