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Andri, Tim

From: Andri, Tim
Sent: Monday, 25 October 2010 2:45 PM
To: Murphy, Jim; Lonsdale, John
Subject: David Liddy comments on Treasury FSAC paper [~~SEC=UNCLASSIFIED~~]
Attachments: Bank Funding and Competition - BOQ.doc; ACHaMP.pdf

Security Classification: ~~UNCLASSIFIED~~

Jim and John

Pls find attached comments from David Liddy on our FSAC paper. He argues that further AOFM support to the RMBS mkt would be the most beneficial funding solution for non-major bank. He also argues that covered bonds would most assist major banks in the short run, giving them a competitive benefit, although non-majors would also benefit in the longer term.

Tim

From: tarryn.mcmullen@boq.com.au [mailto:tarryn.mcmullen@boq.com.au]
Sent: Thursday, 21 October 2010 6:29 PM
To: Andri, Tim
Cc: Kay.Elton@boq.com.au
Subject: Fw: FSAC papers [SEC=UNCLASSIFIED]

Hi Tim,

As you know, David is unfortunately unable to attend tomorrow's FSAC meeting due to our annual results roadshow, however given one of the agenda items is on a topic very close to his heart (bank funding and competition), he's asked me to pass on his thoughts to you on his behalf.

Kind regards,

Tarryn McMullen | Head of MD's Office | Managing Director's Office |
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----- Forwarded by Kay Elton/Bank of Queensland/AU on 20/10/2010 10:17 AM -----

"Andri, Tim" <Tim.Andri@treasury.gov.au>

20/10/2010 09:55 AM

To "pbinsted@bigpond.net.au" <pbinsted@bigpond.net.au>, "rosemary.vilgan@qsuper.qld.gov.au" <rosemary.vilgan@qsuper.qld.gov.au>, "Leanne Cole (CEX)" <Leanne.Cole@macquarie.com>, Ron Pok <rpok@westpac.com.au>, "Lisa_McQuattie@qsuper.qld.gov.au" <Lisa_McQuattie@qsuper.qld.gov.au>, "'lisarobertson@iprimus.com.au'" <lisarobertson@iprimus.com.au>, "'lisa.braidwood@bigpond.com'" <lisa.braidwood@bigpond.com>, "'francinekeeling@capital-investment.com.au'" <francinekeeling@capital-investment.com.au>, "'Sue_Humm@amp.com.au'" <Sue_Humm@amp.com.au>, "'ZSmith@accu.com.au'" <ZSmith@accu.com.au>, "'Sharyn McKitterick'" <Sharyn.McKitterick@bendigobank.com.au>, "'Kay.Elton@boq.com.au'" <Kay.Elton@boq.com.au>, "'Rebecca Agius'" <rebecca.agius@magellangroup.com.au>, "'Keatch, Linda'" <lkeatch@australiansuper.com>, "Prescott, Alison (GE Capital)" <Alison.Prescott@ge.com>, "'Laurinda Moore'" <Laurinda.Moore@iag.com.au>

cc "Kaur, Kanwaljit" <Kanwaljit.Kaur@treasury.gov.au>

Subject FSAC papers [SEC=UNCLASSIFIED]

Dear all

Please find attached the FSAC meeting papers. Apologies for the delay in getting them to you.

The papers consist of the meeting agenda, draft minutes of the previous meeting (agenda item 2), a Treasury paper (agenda item 4) and details of the lunch guest. No papers are provided for other agenda items.

Given the lateness, I don't propose to send hardcopies so would be appreciative if you could print them out and provide them to members. (There are not many pages.) Apologies for any inconvenience.

Should those members not attending wish to provide comments, they can do so directly to the FSAC Chairman, Mr Richard Sheppard.

Note that the lunch guest is the Hon David Bradbury MP, Parliamentary Secretary to the Treasurer.

Thanks
Tim

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Agenda item 4

BANK FUNDING AND COMPETITION

Concerns with sourcing adequate bank funding has been a key discussion item at recent FSAC meetings. The Council recommended a number of measures to the Government at its August 2010 meeting to address these concerns. Additionally, community concerns have emerged at a perceived decline in banking sector competition in the wake of the Global Financial Crisis.

This paper seeks further advice from you on options to address those issues.

Bank funding

FSAC members representing lending institutions have previously advised that their institutions have been experiencing difficulties in sourcing adequate funding. It has been suggested that these difficulties could be exacerbated by Basel III capital holding requirements, noting also, that there is evidence of fierce competition for deposits. Some members have also expressed concern that a possible over-reliance on foreign funding sources poses risks to the banking sector and the broader community.

The Government announced measures to address this issue in the 2010-11 Budget, including a phasing down the interest withholding tax paid by financial institutions on most interest paid on offshore borrowings and a tax discount on interest earned on deposits.

A number of options have been identified by members to strengthen and diversify sources of bank funding, including.

- covered bonds;
- corporate bonds;
- further AOFM interventions in RMBS/securitisation markets;
- retaining the deposit guarantee, and at a relatively high level; and
- implementing the reduction in the rate of interest withholding tax on interest paid on offshore borrowings in full at this time rather than in the phased approach previously announced.

Further options may include, but not be limited to:

- bullet RMBS and other innovative structures; and
- encouraging the superannuation industry to provide funding to the banking system.

Discussion issues:

1. What are the advantages and disadvantages of each of these possible methods and how would they impact large versus smaller lenders?

- **Covered bonds** – Although the introduction of covered bonds would be good for the system in the longer term, it is not a short term solution for non-major banks due to the fact that the strongest credit would need to open this market up. The major banks would get a competitive benefit for a period of time. Also some regional banks / non-major banks may not be able to get to AAA with all three rating agencies.

- **Corporate bonds** - The Government has not provided enough relief here, particularly for highly regulated ADI's. To issue without a prospectus the market needs further guidance on what the expectation is for due diligence.

- **Further AOFM interventions in RMBS/securitisation markets** – This is absolutely the best solution for non-major banks.

- **Retaining the deposit guarantee, and at a relatively high level** – Whilst the cap for the deposit guarantee is still to be decided, non-major banks are concerned that the 'new' deposit guarantee should be structurally different to that of the existing one – when the Government announced the deposit guarantee in October 2008, the fee that was available if a customer wanted to guarantee deposits over $1m was based on the ADI's credit rating. This perpetuated an incorrect perception that a higher rated bank (ie. a major bank) was safer than a lower rated bank (ie. a regional bank). This is fundamentally incorrect due to (a) the same regulatory provisions and oversight apply to all rated ADI's, and (b) you could argue there is a bigger chance that a larger/more highly rated ADI will fail, given their activities in larger and riskier segments and products. Any deposit guarantee structure, if it involves a fee for deposits over a certain size, should have a flat fee.

  In terms of the level of the cap, it should also be noted that non-major banks are exposed to event risk and unscrupulous marketing. There should also be a phased in approach to reducing the level (assuming it will be reduced from $1m).

- **Implementing the reduction in the rate of interest withholding tax on interest paid on offshore borrowings in full at this time rather than in the phased approach previously announced** – The phasing down of IWT has not been rapid enough. Implementing the reduction now would promote inflow of capital and fast growth of the Australian deposit market,

- **Encouraging the superannuation industry to provide funding to the banking system** – Super reform is very important. Australians approaching retirement need to be incentivised into capital stable (cash and fixed interest), not into growth assets (equities). If there is another GFC and equities fall dramatically, the Government could be in the position of having to fund the retirement (and health) of a whole generation. The Government could achieve two goals with one move by structuring incentivisation for increasing fixed interest savings by allocating it to domestic savings only (thereby increasing funding sources for banks).

2. How useful/material would each possible method be in addressing any funding shortfall?

For non-major banks, securitisation is the most effective way to address the funding shortfall (particularly in the short term).

3. Can the Council rank the initiatives in order of importance?

For non-major banks, securitisation is #1.

4. Are there other possible methods to address any bank funding shortfall that should be added to this list?

Competition in the banking sector

Competition in mortgage lending is perceived by sections of the community to have declined due to structural changes in the banking sector stemming from the Global Financial Crisis.

- This is hard to argue given that post-GFC, the four major banks now control over 90% of the market.

Members have previously recommended a number of methods in which the Government could bolster banking sector competition, including:

- further AOFM interventions in RMBS/securitisation markets, noting that a number of small lenders have utilised this previously;
- retaining the deposit guarantee, and at a relatively high level, noting that smaller lenders are relatively reliant on deposits as a funding source; and
- implementing the reduction in the rate of interest withholding tax on interest paid on offshore borrowings in full at this time rather than in the phased approach previously announced.

A further option may include, but not be limited to:

- extending the Government's Account Switching Package to make it easier for consumers to switch between mortgage products and providers.

Discussion issues:

1. What are the advantages and disadvantages of each of these possible methods?

Further AOFM interventions in the RMBS/securitisation markets is the most effective mechanism to increase competition from the non-major banks. However longer term, we need to move away from the AOFM to market-based support – the Canadian model is a good example of this (please refer to the attached information).

2. How useful/material would each possible method be in addressing competition?

3. Can the Council rank the initiatives in order of importance?

4. Are there other possible methods to address competition that should be added to this list?

5. What role are non-regulated market participants, such as mortgage brokers, playing in enhancing or diminishing competition in the banking sector?

Australian Banks

Equity ☑

A CHaMPion mortgage model – One size might fix all?

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- **Canadian mortgage model a solution for Australia** — It is apparent that the Australian banking system has a funding and eligible liquid asset deficiency. Replication of many of the features of the Canadian Mortgage and Housing Corporation may be the most logical solution.
- **Political appeal on several fronts** — While adding to the budget deficit may not appeal, this solution could help provide access to mortgage finance for more Australian families, in effect free up funding capacity for more commercial lending, as well as assisting the competitive landscape in banking.
- **Wholesale funding demand and consequently the price of credit would fall** — Canadian banks have lower credit ratings than Australian banks yet raise their term wholesale funding at tighter prices given much lower issuance in open markets.
- **Regional banks, CBA and WBC the relative winners** — Competition would be significantly enhanced given a deeper pool of cost effective funding for the mortgage market. CBA and WBC would have significantly less pressure to raise money in term wholesale markets where they have been among the Top 5 global issuers in recent years by both absolute volumes and as a percentage of balance sheet assets.
- **Would fix one of APRA's big regulatory headaches too** — Either direct Government issuance or eligible mortgages with the Government's top-notch credit rating backing them could be used to significantly deepen the pool of eligible securities for the liquidity requirements of the banks.
- **CMHC actually pays its way and adds policy flexibility** — Far from being a drain on the Government's coffers, even in a difficult 2009, the entity recorded net income of C$931m.
- **Risks and their mitigation** — While adding to a budget deficit and increasing the direct liabilities on the Federal Government balance sheet, there is a degree of inevitability about wearing such risks and meeting these costs.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Taking a leaf out of the Canuck playbook

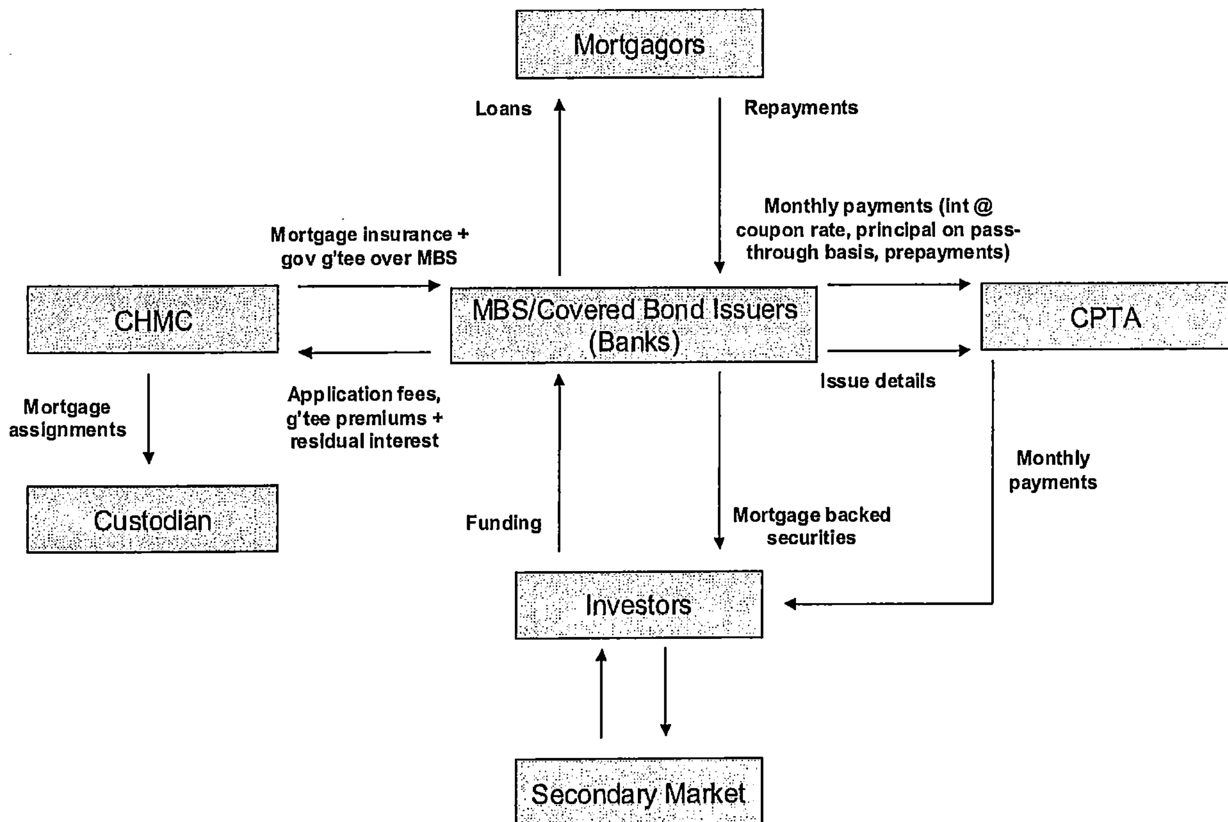
Canadian banks, like the Australian banks, had a 'good' financial crisis. An oligopolistic market structure, good financial regulation and a resource-exposed economy are some of the traits which the two markets share in common.

Unlike Australia's banks though, Canada's banking system does not face the extent of the funding problem that local banks in this country face. Nor does compliance with Basel III regulation seem as difficult given a deeper pool of eligible liquid assets. One of the key reasons for this is the existence of the Canada Mortgage and Housing Corporation (CMHC) which has been assisting the function of the Canadian mortgage market for almost 65 years. Far from being another "Fannie and Freddie", the Canadian model, may be just the medium-term solution that the Australian banking market requires.

It's not time to 'blame Canada', but more logically to embrace Canada. Consequently, we're advocating the creation of ACHaMP – Australian Corporation of Housing and Mortgage Provision!

Canada's mortgage market model – one size fits many (problems)

Figure 1. Canadian Mortgage and Housing Corporation (CHMC) and the Canadian mortgage market model



Source: Citi Investment Research and Analysis

The Canadian Mortgage and Housing Corporation website notes:

"CMHC, established in 1945, is the Canada Mortgage and Housing Corporation, a Crown corporation wholly owned by the federal government.

Through CMHC, the federal government is committed to helping house Canadians across the country at an affordable price. In general terms, CMHC's mandate, as outlined in the National Housing Act, is 'to promote the construction of new houses, the repair and modernization of existing houses, and the improvement of housing and living conditions.'

CMHC has provided Mortgage Loan Insurance to protect NHA Approved Lenders in both urban and rural communities from borrower default, and by doing so has helped support a private housing market that now meets the needs of some 80 per cent of Canadians."

Market participants include:

Canada Mortgage and Housing Corporation (CMHC) — The administrator of the NHA MBS program and the guarantor of timely payment on behalf of the federal government. This Government of Canada agency approves all NHA MBS issues.

Investors — Individuals and institutions, such as pension funds and corporations (both Canadian and foreign).

MBS Issuers — These include financial institutions that are already operating as Approved Lenders of NHA-insured mortgages: banks, trust companies, insurance companies, loan companies, credit unions and caisses populaires. Other financial institutions that are not originators of the underlying mortgages, such as investment dealers, may become issuers. Issuers CMHC approved.

Investment dealers, stock brokers and financial advisors — Canada's investment industry and other financial organizations are active participants.

Central Payor and Transfer Agent (CPTA) (notably Aust. listed Computershare).

Custodians — Organizations authorized by CMHC to hold the mortgage assignments (security for NHA MBS pools) on behalf of investors and CMHC.

Importantly, this entity is wholly owned by the Canadian Government, meaning that unlike Freddie and Fannie Mae (its celebrated but problematic US peers), it does not feel the same compulsion to seek growth as a listed entity and broaden its risk tolerance in an effort to deliver upon shareholder expectations.

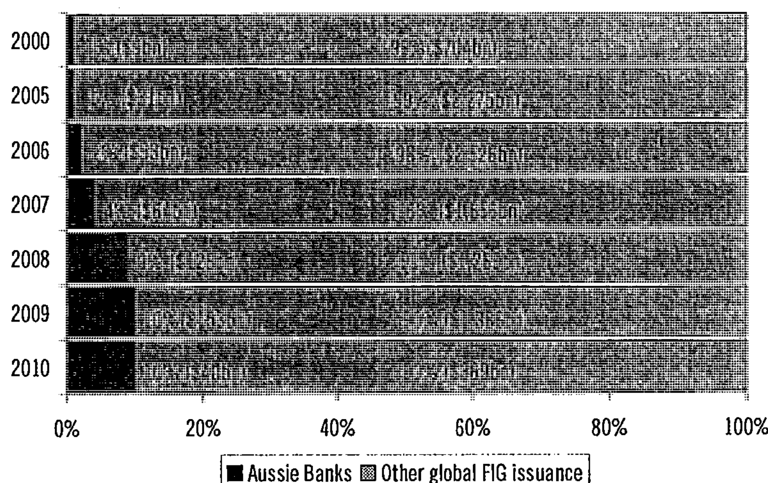
Other facts about the Canadian mortgage market

- Total market size estimated at US$1.3trn.
- Proportion securitised ~30%, of which 29% ABS and 1% covered bonds (which are limited to 10% of outstanding mortgages).
- 43% of mortgages guaranteed by the Government. All mortgages above 80% are compulsorily mortgage insured.
- Predominantly a 5 year fixed rate mortgage amortising over 25 years.
- Minimum down payment of 5%, maximum term 35 years.
- Full recourse to the borrower.

We think the creation of ACHaMP, potentially provides a solution to several of the major problems facing the Australian banking system and consequently the broader economy.

A funding solution – relieving the pressure on offshore issuance

Figure 2. Australian banks 10% of global Fin'l Institutions term wholesale funding issuance in 2009



Source: Dealogic, Bloomberg, Citi Investment Research and Analysis

In addition, recent mortgage volumes out of CBA and WBC (growth ~0.5x system) indicate that each has a degree of discomfort with its current and prospective annual wholesale funding requirements. Despite maintaining higher credit ratings, Australian banks pay more for term wholesale funding than their (modestly) lower-rated Canadian major bank counterparts.

Australian banks have demonstrably higher Loan to Deposit ratios than their Canadian counterparts

Figure 3. Australian vs. Canadian major banks

	Average LDR
Australia (majors)	150%
Canada (RBC, TD Bank, Scotiabank, BMO, CIBC)	70%

Note: Australia as at 1H10 with CBA at FY10, Canada as at end 3Q10 (31 July 2010)
Source: Company Reports

Our discussions with senior Australian bank executives indicate that a 5 year term funding issue is currently around 70-80bps more expensive for an Australian major bank versus the Canadian major banks. This likely reflects the more modest level of issuance done by the Canadian banks (scarcity factor) as well as concerns about the ability of the Australian banks to maintain cost effective funding and consequently industry returns on asset levels.

Continued increasing reliance on funding in wholesale markets could continue to see upward pressure placed upon the overall cost of funding for Australian banks considering:

- The overall level of growth in foreign savings pools should only be about nominal GDP in the primary markets from which the banks source this money (US, UK, Europe etc).

- Australian banks already proportionately represent the largest bank issuers of paper in global term debt markets at ~10%.
- A lack of issuance by foreign corporations into the Australian debt markets may continue to see swap costs widening.

This would consequently likely necessitate lenders having to put up the price of credit, particularly mortgages (as the predominant form of lending on Australian bank balance sheets), which would be politically problematic for the prevailing Federal Government and eventually problematic for the banks given the likely increase of loan arrears and cessation in demand for credit.

With the introduction of ACHaMP and therefore lower issuance in the broader international wholesale markets, Australian banks would likely be able to raise their funding at lower prices. In effect, this would mean more term wholesale funding would be available to be directed toward commercial lending including SME's who do not have access to corporate bond markets, domestically or abroad, like Australia's largest corporates do.

2008 Canadian Mortgage Bonds Program Evaluation

In the 2008, the Canadian Mortgage Bonds Program Evaluation was released. It was conducted in order to examine the effectiveness and efficiency of the Canadian mortgage market. Its examinations were from activity up to the 2006 period.

The report's major conclusions included:

"In the interviews the banks often described the advantage (cost advantage of CMHC funding versus the lowest cost term wholesale funding – deposit notes) to be in the range of 10-20 basis points. In fact, several of the banks indicated that they use a 15 basis point cost advantage in their internal analysis......

Less benefit for smaller lenders given the all-in cost of their CMB-funding is higher due to the swap and the operational complexity of administering the CMB program.......

An upper bound estimate of total savings to mortgage borrowers over the study period due to the CMB program is $426 million. At the December 2006 level of CMB outstanding ($96 billion), the annualized savings to borrowers could be up to $174 million."

With respect to the lesser advantage for smaller lenders, we note that this pertains to very small organisations which had previously not managed securitisation funding programs. Most smaller Australian lenders however already issue and manage securitisation programs.

A liquidity solution – Gov't g'teed MBS and covered bonds

Figure 4. Class 1 Eligible Liquids (% of total liquid asset holdings)

	ANZ	CBA	NAB	WBC
Class 1 as a % total liquids	36%	22%	22%	16%

Note: CBA FY10A, all other banks FY10E
Source: Company Reports, CIRA Estimates

To quote from the CMHC website:

"The NHA MBS represents an undivided interest in a pool of NHA-insured residential mortgages. As mortgages, these financial instruments are secured by the value of the underlying real estate.

CMHC provides Mortgage Loan Insurance on all pooled mortgages and an unconditional guarantee under the National Housing Act (NHA) of timely payment to NHA MBS investors.

These securities, as investments, combine the investment qualities inherent in both real estate mortgages and Canadian Government bonds."

The last sentence tells a tale. The securities created by an Australian equivalent body could be purchased by banks as part of their eligible liquid assets given a relative absence of Class 1 liquids currently on issue in the Australian market.

While it may just be achievable to expect Australian banks to meet the Basel III minimum of 60% Class 1 eligible liquids, there is also a deficiency of other qualifying liquids in the Australian market (e.g. highly rated non-financial corporation bonds, covered bonds etc) with which to compile the additional 40% of bank liquidity requirements.

As a form of Government Guaranteed paper, ACHaMP-sponsored MBS would likely maintain better liquidity in a stress situation. This would therefore likely pass APRA's requirement to find alternate eligible liquid assets for bank liquidity requirements under Basel III.

Competition solution – regionals and non-banks to re-emerge

Figure 5. ROE and funding cost

	Avg FY10 ROE	5 year term issuance spread (bps)
Major banks	15%	160
Regional banks	8%	275*

Source: Citi Investment Research and Analysis, * estimated spread

Regional bank CEOs have been heard bemoaning their inability to effectively compete in the banking market and the ACCC's recent decision with respect to NAB's bid for AXA suggests they have some serious concerns about the market power which the major banks now wield.

Given a guaranteed source of competitive (i.e. top-notch credit rated) funding for qualifying mortgages, regional banks among others would be able to use this as a significant source of funding for their mortgage portfolios, which currently constitute around three-quarters of their lending assets. The residual piece of the MBS, as is the case in the Canadian market, could be purchased by 'ACHaMP'. This would present a 'clean-sale' for regulatory capital purposes under the securitisation treatments proposed by APRA under Basel III, meaning that it would also become a capital efficient way to lend. Currently, the smaller regional banks are virtually unable to issue into foreign funding markets, with the pricing at prohibitive levels and securitisation markets thin, with the government sponsored Australian Office of Financial Management (AOFM) providing much of the demand.

The result of this uncompetitive funding and capital position is reflected in the current ROE's earned by each class of bank at the current time as shown in Figure 5 above.

Foreign banks with ADI licences would also be eligible to tap this funding source, adding further competition in the market and further helping to keep a 'lid' on mortgage pricing.

2008 Canadian Mortgage Bonds Program Evaluation

The report's major conclusions included the observation that smaller organisations (incl. life offices) had been able to maintain their share of the mortgage market, ensuring competition remained healthy.

".... since this sector are generally more capital constrained than their larger rivals, the maintenance of share can be seen to have been attributed in part to the introduction of the CMB scheme.......

The CMB program has supported the entry/expansion of smaller lenders because of its role in facilitating funding for mortgages by purchasing mortgages from them (mainly through aggregators and institutional investors). Funding to smaller lenders would probably have been more constrained in the absence of CMB funding. The program has also indirectly facilitated market access for smaller lenders due to its [indirect] support for the growth of the broker channel...."

There has been a notable reduction in the incidence of smaller market players in the Australian mortgage market since the Global Financial Crisis and dramatic slow down of securitisation markets. The introduction of ACHaMPS would likely be a factor which would contribute to the re-emergence of smaller institutions in the Australian mortgage market.

An additional policy solution

In addition to traditional fiscal and monetary policy tools, the Canadian Government has in effect created an industry expert body which can be used to implement and extend Government economic and social objectives.

For example, in addressing the challenges of the Global Financial Crisis, the Government of Canada introduced a C$25 billion Insured Mortgage Purchase Program in October 2008. Under the program, the CMHC could purchase from lenders up to $125billion in NHA Mortgage backed Securities backed by insured loans. This was well utilised by Canadian lenders, who saw it as a valuable option in managing their funding needs in the face of ongoing pressures.

The CMHC also carries out the administration of building of social housing units across Canada.

Potential risks with such a model

The primary concerns with such a model being introduced could include:

1. the Federal Government being 'on the hook' for meeting claims over a large part of the mortgage market in the event of a significant reduction in property values – 'Freddie and Fannie Mae'.
2. an increase in the budget deficit as the Federal Government is required to fund the purchase of residual equity in securitisation pools.

Response to risk 1

We would note that, in effect the Government has an implicit guarantee over the banking system and the mortgage market in the event of a wide scale problem in this market. It is one of the reasons why the Australian major banks carry the strong 'AA' credit rating.

More specifically, the Government could elect not to provide mortgage insurance on loans with a loan to value ratio above 80% at the time of origination. This would more clearly demonstrate that the primary benefits of ACHaMP were as a funding and liquidity tool rather than as a credit risk mitigation tool. Such a policy would also ensure that private mortgage insurers such as Genworth and PMI/QBE suffered less 'crowding out' from ACHaMP and would leave underwriting of the higher risk mortgages to these specialised commercial insurance providers.

A critical difference between the CMHC (and our proposed ACHaMP) model and Freddie Mac/Fannie Mae model is the ownership structure. We believe that the listed ownership structure of Freddie and Fannie led to a stronger bias toward growth. In order to support this ambition, underwriting was extended to new risk classes and consequently credit extended to households without robust financial circumstances.

The CMHC model, as a Government controlled entity, has been without the same bent toward growth and has only been a sponsor of prime mortgage lending, with underwriting of risk much more in keeping with historic Australian mortgage standards.

Response to risk 2

While clearly this is true, one of the problems that the introduction of such a scheme would be trying to mitigate is the recognition that the Australian banks are reaching the prudent limits to which they can fund the investment in the Australian economy. The Government maintains a very lowly indebted and highly-rated balance sheet and probably needs to utilise this more for the betterment of the economy and the financial system. Whether it be a case of investment in the mortgage market or via public private partnerships, the Government will likely be called upon to fund more of Australia's investment needs in the future.

We would offer that the benefits of this scheme, if well managed, would far outweigh the risks posed.

Appendix – Financial summary of the CMHC

Figure 6. A snapshot of the CMHC

Corporate Results	2005 Actual	2006 Actual	2007 Actual	2008 Actual	2009 Plan	2009 Actual	2010 Plan
Total Assets ($M)[1]	101,093	124,218	148,168	203,461	345,318	272,821	321,200
Total Liabilities ($M)[1]	96,665	118,764	141,174	195,291	335,484	263,558	311,261
Reserve Fund ($M)	143	143	121	185	177	151	17
Total Equity of Canada ($M)	4,428	5,454	6,994	8,170	9,634	9,263	9,939
Total Revenues ($M)[1]	7,409	8,378	9,320	11,738	15,966	13,164	15,359
Total Operating Expenses ($M)[1&2]	303	298	347	385	460	416	494
Total Expenses ($M)[1]	5,945	6,896	7,746	9,319	14,061	11,939	14,091
Net Income ($M)	1,002	1,026	1,070	1,776	1,353	931	911
Other Comprehensive Income ($M)	n/a	n/a	(200)	(604)	65	483	42
Comprehensive Income ($M)	n/a	n/a	870	1,174	1,418	1,414	953
Staff-Years	1,604	1,877	1,888	1,945	2,030	1,999	2,138
Insurance							
Annual Insurance Units Approved	746,157	631,191	803,151	919,790	873,375	1,187,652	960,944
Insurance-In-force ($M)	273,700	291,400	345,200	407,700	440,800	472,564	519,100
Premiums and Fees Received ($M)	1,492	1,383	1,740	2,132	2,023	2,464	2,246
Investments (including cash) ($M)[3]	9,053	9,974	12,026	12,974	15,710	15,830	16,561
Unappropriated Retained Earnings ($M)	657	1,313	1,942	1,778	3,293	2,009	2,004
Retained Earnings Set Aside for Capitalization ($M)	3,406	3,731	4,258	5,423	5,304	5,937	6,769
Net Insurance Claims Expense ($M)	119	209	315	372	279	1,112	647
Net Income ($M)	951	981	1,022	999	1,243	742	999
Other Comprehensive Income ($M)	n/a	n/a	(187)	(527)	24	411	57
Comprehensive Income ($M)	n/a	n/a	835	472	1,267	1,153	1,056
Securitization							
Annual Securities Guaranteed ($M)	30,374	36,071	57,981	104,625	167,000	135,447	66,000
Guarantees-in-force ($M)	103,709	129,500	165,332	233,958	372,600	300,320	396,600
Borrowings from the Government of Canada ($M)	n/a	n/a	n/a	24,872	126,390	61,260	69,493
Fees Received ($M)	68	85	131	226	444	291	177
Investments (including cash) ($M)[3]	327	396	533	25,559	126,117	62,260	70,616
Unappropriated Retained Earnings ($M)	197	242	305	938	504	409	602
Appropriated Retained Earnings ($M)	n/a	n/a	n/a	n/a	n/a	538	603
Net Income ($M)	42	45	58	633	126	69	(70)
Other Comprehensive Income ($M)	n/a	n/a	(7)	(24)	41	27	(6)
Comprehensive Income ($M)	n/a	n/a	51	609	167	96	(76)
Housing Programs							
Housing Program Expenses ($M) (excluding operating expenses)	1,973	2,049	1,912	2,288	2,247	2,505	3,001
Affordable Housing Initiative Expenditures ($M)[4]	175	167	95	98	93	120	168
Estimated Households Assisted through long-term Commitments	633,000	630,000	626,300	623,700	621,700	620,000	612,700
New Commitments (units) under Renovations Programs:	21,990	20,535	19,049	21,506	18,712	18,000	18,783
On-reserve	1,508	2,421	1,171	1,063	1,169	1,193	1,069
Off-reserve	20,482	18,114	17,878	20,443	17,543	16,807	17,714
New commitments On-reserve Non-Profit Units[5]	1,045	4,393	1,442	945	774	822	697
Lending							
Loans and Investments in Housing Programs ($M)	13,170	12,706	12,341	12,340	12,210	11,727	12,795
Borrowings from Capital Markets ($M)	9,467	8,625	8,295	5,979	4,211	4,448	3,300
Borrowings from the Government of Canada ($M)	4,899	4,701	4,446	7,746	8,930	8,593	10,977
Net Income ($M)	9	0	(19)	64	(16)	(16)	(30)
Canada Housing Trust							
Assets ($M)	73,208	96,445	120,122	150,669	187,543	182,206	222,364
Liabilities ($M)	73,208	96,445	120,122	150,669	187,543	182,240	222,364

Source: CMHC

Commonwealth Bank of Australia

(CBA.AX; A$51.49; 2M)

Valuation

Our 12-month target price of A$56.50 is based on an implied 12-month target PE ratio of 12.2x. This PE ratio is derived by using our forecast payout ratios and a dividend-to-bond yield premium based on future earnings growth prospects.

Risks

We rate CBA Medium Risk referencing a number of quantitative and fundamental screens. We believe banks' share prices and earnings performance are subject to common factors and risks - net interest margin pressure, interest rate risk, market risk, operational risk and the spectre of reregulation.

CBA is the Australian bank most leveraged to movements in equity markets through funds management/wealth management. In addition, the bank now faces an integration of the BankWest acquisition, which closed during 2009. From a positive perspective, Ralph Norris's history of managing cultural change raises the prospect of material upside to consensus estimates for CBA, should he be able to harness the power of the bank's distribution network. Adverse or favourable movements in these risk factors may cause CBA's share price to deviate from our target price.

Westpac Banking Corp

(WBC.AX; A$23.30; 2M)

Valuation

Our 12-month target price of A$25.00 is based on an implied 12-month target PE ratio of 11.0x. This PE ratio is derived by using our forecast payout ratios and a dividend-to-bond yield premium based on future earnings growth prospects.

Risks

We rate WBC Medium Risk referencing a number of quantitative and fundamental screens. We believe banks' share prices and earnings performances are subject to common factors and risks - funding rollover risk, net interest margin pressure, interest rate risk, market risk, operational risk and the spectre of re-regulation.

Regulatory risk represents a notable risk for the stock and sector at present, with funding representing a material ongoing challenge for Westpac. From a positive perspective, future margin expansion opportunities may deliver upside if for example WBC is able to pass on a greater portion of the costs associated with regulatory changes than we currently assume or a more favourable (e.g. political) environment allows for greater asset re-pricing. Adverse or favourable movements in these risk factors may cause WBC's share price to deviate from our target price.

Appendix A-1

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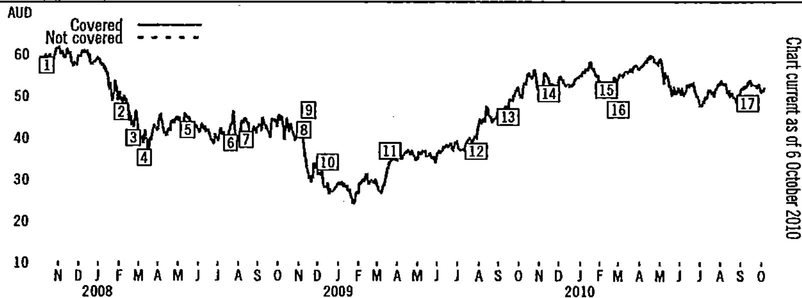

	Date	Rating	Target Price	Closing Price
1	15-Oct-07	2L	*57.00	59.38
2	5-Feb-08	2L	*55.70	49.82
3	22-Feb-08	*1M	*52.00	42.59
4	11-Mar-08	*2M	*42.50	39.66
5	15-May-08	2M	*46.50	44.82
6	21-Jul-08	2M	*41.00	43.35
7	13-Aug-08	2M	*42.00	44.05
8	10-Nov-08	*3M	*35.00	38.00
9	17-Nov-08	*2M	*34.00	31.33
10	16-Dec-08	2M	*30.50	29.15
11	20-Mar-09	2M	*35.50	34.00
12	29-Jul-09	*1M	*45.95	39.90
13	15-Sep-09	1M	*54.00	46.51
14	16-Nov-09	1M	*60.00	53.96
15	10-Feb-10	*2M	*56.50	51.83
16	1-Mar-10	2M	*58.00	54.45
17	10-Sep-10	2M	*56.50	52.67

* Indicates change

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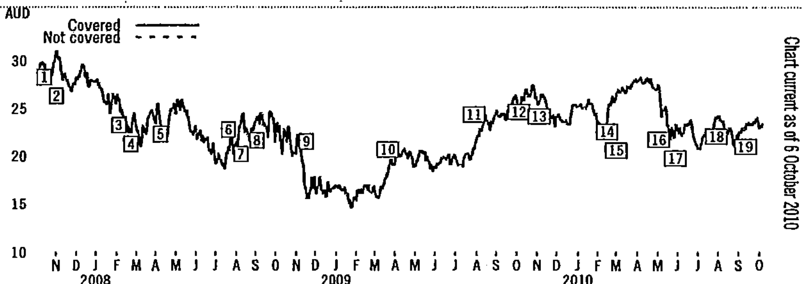
Westpac Banking Corp (WBC.AX)

Ratings and Target Price History
Fundamental Research
Analyst: Craig Williams



	Date	Rating	Target Price	Closing Price
1	15-Oct-07	*2L	*29.00	29.70
2	1-Nov-07	2L	*30.00	31.06
3	5-Feb-08	2L	*29.00	25.90
4	22-Feb-08	*1M	*26.00	22.47
5	8-Apr-08	*2M	*25.60	23.55
6	21-Jul-08	2M	*21.00	21.06
7	8-Aug-08	2M	*22.50	23.55
8	2-Sep-08	2M	*23.00	24.05
9	17-Nov-08	2M	*17.00	16.32
10	20-Mar-09	2M	*19.00	18.17
11	29-Jul-09	*1M	*24.47	20.81
12	5-Oct-09	*2M	24.47	24.67
13	4-Nov-09	2M	*25.50	25.79
14	15-Feb-10	*1M	*26.50	23.30
15	1-Mar-10	1M	*28.75	26.53
16	4-May-10	*2M	28.75	27.33
17	28-May-10	2M	*25.25	23.40
18	29-Jul-10	2M	*26.25	24.25
19	10-Sep-10	2M	*25.00	22.94

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