

RatingsDirect®

Capital And Government Support Emerge As Key Issues In Australia's Financial System Inquiry

Primary Credit Analyst:

Sharad Jain, Melbourne (61) 3-9631-2077; sharad.jain@standardandpoors.com

Secondary Contacts:

Nico N DeLange, Sydney (61) 2-9255-9887; nico.delange@standardandpoors.com

Lisa Barrett, Melbourne (61) 3-9631-2081; lisa.barrett@standardandpoors.com

Andrew Mayes, Melbourne (61) 3-9631-2078; andrew.mayes@standardandpoors.com

Michael D Puli, Sydney (61) 2-9255-9823; michael.puli@standardandpoors.com

Peter Sikora, Melbourne (61) 3-9631-2094; peter.sikora@standardandpoors.com

MELBOURNE (Standard & Poor's) Oct. 20, 2015--Standard & Poor's Ratings Services reports that the Australian government's response to the Financial System Inquiry (FSI) announced today is in line with our previous expectations. We note that the government has accepted most of the inquiry's 44 recommendations.

Although there are a number of specific recommendations aimed at strengthening the Australian financial sector, we consider the following two broad areas have the potential for greatest impact on the credit profiles of the banks operating in Australia:

- Increase in regulatory capital requirements
- Developments on resolution framework

In our view, the Australian banking regulator, the Australian Prudential Regulation Authority (APRA), has already implemented and charted a clear path for increasing regulatory capital requirements for particularly the major Australian banks. We consider that this has the potential to strengthen the major Australian banks' stand-alone credit profiles (SACPs, in this case defined as credit profiles excluding expectation of extraordinary government support), all other things remaining unchanged. If this were to occur, we expect to raise ratings on hybrid instruments and non-deferrable subordinated

debt instruments issued by such banks--because in the case of these banks, the ratings on such instruments are more sensitive to changes in the SACP. Nevertheless, we expect that in this scenario, issuer credit ratings and ratings on senior debt would remain unchanged.

Initiatives that boost the Australian major banks' regulatory capital requirements will help bridge the 200 bps gap estimated by APRA in a study completed earlier in the year. This study was aimed at positioning these banks' capital adequacy positions in the top quartile of a group of international banking peers--a position notionally deemed as "unquestionably strong" by APRA. We believe that the main impact of greater harmonization of regulatory capital requirements for the Australian banks--specifically the risk weights on residential mortgages held by the banks subject to internal-ratings-based (IRB) and standardized frameworks--is the stronger capital levels held by IRB banks. The impact of this change on relative business outcomes would be modest, in our view.

We believe that the announcements and progress to date in relation to the resolution framework suggest that there remains material uncertainty about the Australian government and regulator's plans in relation to bank crisis-resolution framework. Indeed, the Australian authorities appear to be in no hurry to implement a European-style statutory "bail-in" of all the senior debt issued by the banks, in a crisis. Nevertheless, in our opinion the announcement of a high-level time table for starting consultations on this matter next year suggests that there is potential for lessening of likely timely financial support from the government to the systemically important private sector banks, if needed. Additionally, we note that the government has endorsed taking steps in line with the emerging international practice to reduce any implicit government guarantee and the perception that some banks are too big to fail, including the use of greater loss-absorbing capital to facilitate orderly resolution. We will continue to monitor developments in this matter to review if and to what extent they weaken the likelihood of government support for the banking system.

We consider that the government and regulators' responses on the remaining topics addressed by the FSI are broadly supportive of the regulatory and governance framework, whose strengths, in our opinion, continue to underpin the stability of Australian financial system. Nevertheless, we believe that the actions on these remaining topics are less likely to have a material impact on the credit quality of Australian banking system.

We have determined, based solely on the developments described herein, that no rating actions are currently warranted. Only a rating committee may determine a rating action and, as these developments were not viewed as material to the ratings, neither they nor this report were reviewed by a rating committee.

AUSTRALIA

Standard & Poor's (Australia) Pty. Ltd. holds Australian financial services

licence number 337565 under the Corporations Act 2001. Standard & Poor's credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

Copyright © 2015 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.