

Three factors pushing Australian banks into a retreat home

Written by The Conversation USA

History shows that successfully becoming a multinational bank operating in many countries is difficult.

While many banking skills are transferable across national borders, there are institutional and cultural impediments to overcome. And as ANZ's strategy shift away from Asia announced last week might demonstrate, the regulatory barriers are significant, particularly for expansion into Asia.

First among these is the ASEAN Banking Integration Framework (ABIF) initiated at the end of 2014. This involves the designation of banks headquartered in the ASEAN region as Qualified ASEAN Banks (QABs).

Such a designation - not available to Australian banks - means that they will be able to operate in other ASEAN countries under exactly the same regulatory arrangements as domestic banks. While the specific competitive advantages this will provide over non-QABs are unclear (and may vary from country to country), this is in essence a barrier to entry for banks from outside the ASEAN region.

It remains to be seen whether the ABIF will succeed, given the vast differences in banking structure and development across the region, not to mention political factors. Nevertheless, the development is not conducive to an Asian expansion strategy for Australian banks.

A second factor is the regulatory arrangements driven by the Basel Committee, and implemented in Australia by banking regulator, APRA. Capital requirements associated with offshore subsidiaries or joint ventures can be higher than for purely domestic operations.

The Australian banks have complained about this in the past and given bankers' aversion to higher capital, that also creates a disincentive to offshore operations. (Given generally poor experience with bank offshore expansion over the years, that may be a good result for bank shareholders arising from such regulation).

Three factors pushing Australian banks into a retreat home

Written by The Conversation USA

A related regulatory consideration is the imposition of higher capital requirements on banks which are regarded as systemically important. The major Australian banks are already subject to a higher capital charge for being Domestic Systemically Important Banks (D-SIBS), but offshore expansion could ultimately lead to a Global SIB categorisation and further capital imposts. In general, the thrust of post-crisis regulation is towards disincentives for banks becoming “too big”.

A final factor, virtually unique to Australia, arises from tax considerations. An increasing share of earnings generated offshore would reduce the ability of Australian banks to pay fully franked dividends. This is equivalent to banks facing a higher cost of capital for overseas activities than for domestic activities.

For shareholders (such as this writer) in ANZ or other Australian banks, this would mean that offshore expansion would need to be even more profitable than domestic activities to be value adding. Then, and it is an unlikely outcome, higher partially franked dividends could be paid to offset the reduction in franking.

So: the cost of capital is probably higher for overseas versus domestic activities of Australian banks (due to dividend imputation); capital requirements are a bigger problem; and the ASEAN region is putting some potential roadblocks in place which hinder ease of foreign bank entry and competitiveness.

And added to all that is the massive potential disruption to traditional banking being posed by innovation and Fintech, requiring a focused response to preserve competitive advantages in existing markets and products.

Retreat to Australia sounds like a sensible response for Australian banks.

Kevin Davis does not work for, consult, own shares in or receive funding from any company or organization that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.

Three factors pushing Australian banks into a retreat home

Written by The Conversation USA

Read more <http://theconversation.com/three-factors-pushing-australian-banks-into-a-retreat-home-53970>