Foreign Bank Tracker

Mapping capital flows into Australia

2018 Edition

Capital Markets & Corporate



MinterEllison

Introduction

Welcome to the 2018 Foreign Bank Tracker (FBT). I'm delighted to introduce this year's report - the third in our series. MinterEllison's FBT draws on Australian Prudential Regulatory Authority (APRA) statistics to unveil trends and foreign capital flowing into Australia via foreign banks.

There are 50 foreign banks operating in Australia today. These banks represent 34% of Authorised Deposit-taking Institutions (ADIs).

During the nine years of APRA statistics analysed, total resident assets owned by foreign banks have increased from A$315 billion to A$390 billion.

While this growth is steady, if not remarkable – on closer analysis we see Asian bank expansion certainly is.

Since 2009, Asian banks have almost tripled their total volume of resident assets to A$128.5 billion. Today there are 26 Asian banks operating in Australia, more than double since 2009. Asian banks represent eight of the top 10 banks for growth. New entrants are from Mainland China and Taiwan, Korea and Japan.

For this reason, this year's FBT has a strong focus on mapping Asian bank growth – using European and North American statistics as a baseline for comparison.

I hope you find the story of foreign bank growth as fascinating as I do.

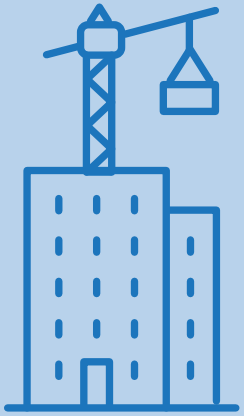


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Key Highlights

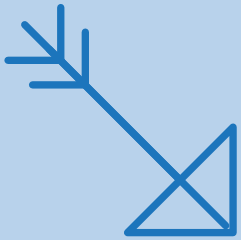
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new bank entrants from Asia



Asian banks increase lending in infrastructure and commercial property industries

Asian bank growth drops for the first time since 2013



Canadian Imperial Bank of Commerce and The Bank of Nova Scotia among top five highest performing banks



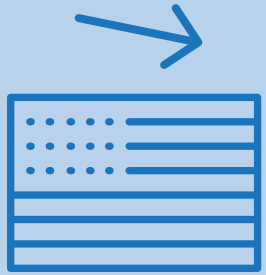


European banks show signs of recovery with 6% growth

Canadian banks record strong YOY growth of

63%

US bank growth dips from 0.5% to -3%

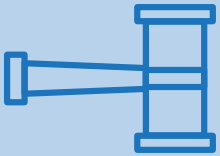




European banks experience first two years of consecutive growth since 2005

Regulatory Developments

Three major challenges ahead



Royal Commission

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Commission) held its initial public hearing on 12 February 2018. The Commission, which is being led by former High Court Justice Kenneth Hayne, will inquire into the nature of misconduct by financial services entities, the adequacy of existing laws and the effectiveness of regulators and the current legal framework. It is expected the Commission's final report, due February 2019, will include recommendations for legislative change, which may affect foreign banks in Australia.

"Since the financial crisis... there have been examples of misconduct by financial institutions – some of them extremely serious and that's demanded a response from the institutions themselves and from government."

The Hon. Malcolm Turnbull MP,
Australian Prime Minister



Banking Executive Accountability Regime (BEAR)

The Australian Government has introduced a new accountability regime, which applies to ADIs as well as their directors and senior executives who are 'accountable persons' (APs) under the regime.

BEAR commences on 1 July 2018 for large ADIs and 1 July 2019 for all other ADIs. BEAR will apply to ADIs that are Australian branches or subsidiaries of foreign banks.

The regime imposes new 'accountability obligations' on ADIs and APs, obligations on ADIs regarding the remuneration of APs and requires ADIs to report certain matters to APRA. Under BEAR, APRA will have new enforcement powers, including the power to impose substantial fines on banks and disqualify APs.



Foreign Investment Review Board (FIRB)

Australia's foreign investment regime was significantly amended in December 2015 and is now more complex, more costly and exposes foreign investors (and their financiers) to increased transaction uncertainty.

While foreign financiers are often able to rely on the moneylending exemption for their transactions in Australia, the availability of the exemption needs to be tested on a case-by-case basis. In addition, it is in every financier's interest to take measures to ensure its borrowers are compliant with Australia's foreign investment legislation, as misapplication of the legislation by borrowers can affect the priority of financier's security interests.

The Global Picture

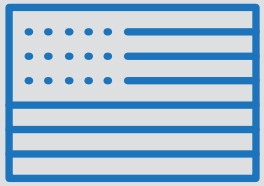
Asia | Europe | US & Canada



European banks showing signs of recovery (6% YOY growth)



Asian banks record a respectable 8% YOY growth



US bank growth dips slightly

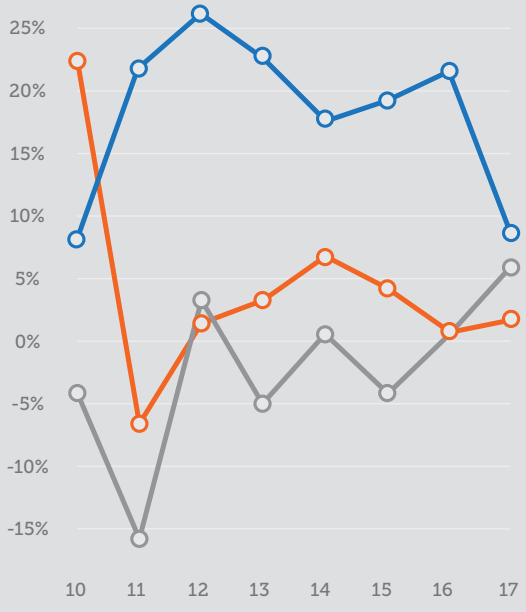
$A389.6BN

Total resident assets held by all foreign banks sit at A$389.6 billion.



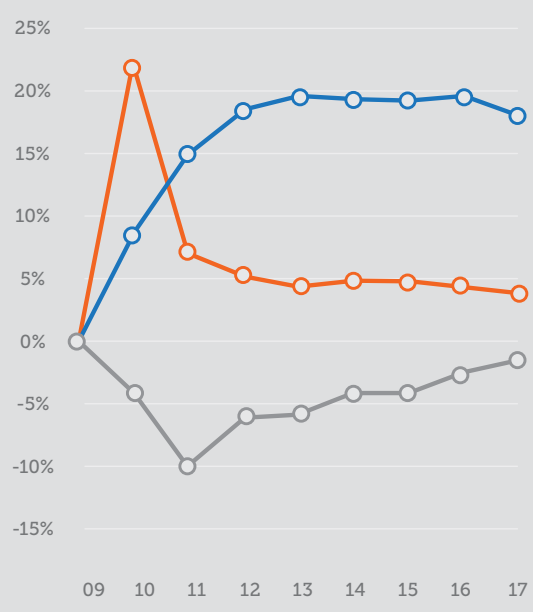
There is strong and consistent YOY growth of Asian bank performance against European and US banks.

YOY Growth of Resident Assets of Foreign Banks in Australia



We are seeing the gradual recovery of European banks, and a steadying (perhaps more sustainable) growth rate of Asian banks after six consecutive years of rapid growth.

Compound Annual Growth Rate of Total Asset Value since 2009

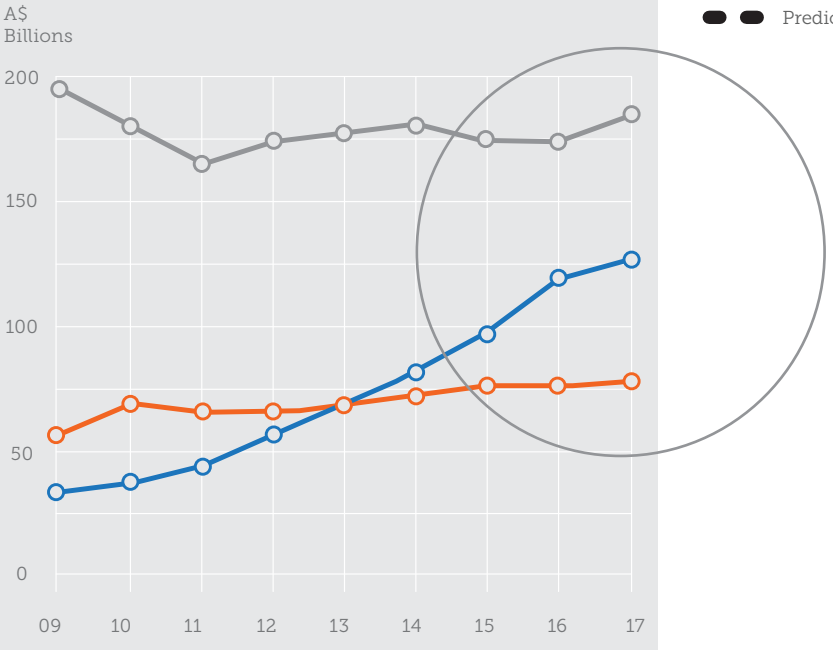


The Global Picture

- Last year's FBT revealed Asian banks were on track to close or even overtake the resident asset gap on European banks this year. However, we now see a marked decline in growth which can be attributed in no small part to Chinese capital controls. In our view, the slowdown in Asian investment is likely to be more sustainable than the expansion from previous years
- After a period of retrenchment, European banks have become active again, recording 6% YOY growth last year
- US and Canadian bank growth is flat – however closer analysis shows Canadian bank growth to be particularly strong with two banks (see Canada section).

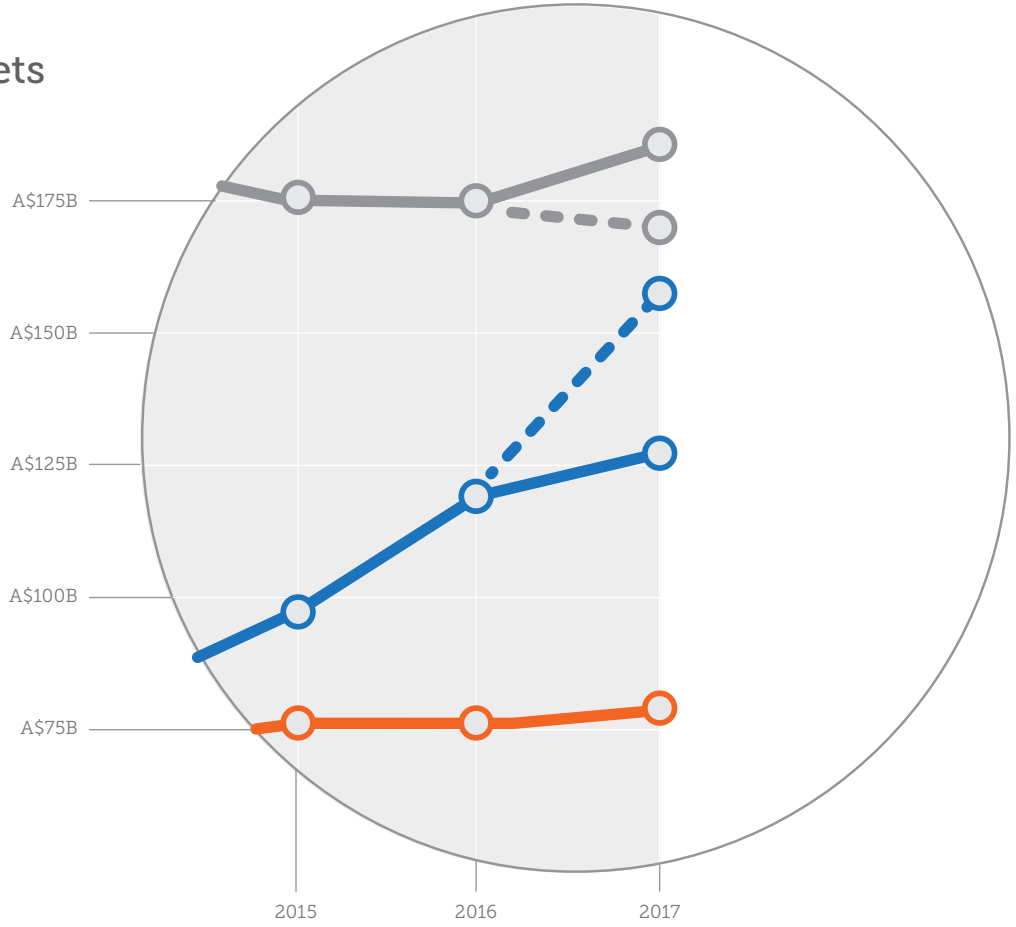
Asia
Europe
US & Canada

Total Resident Assets held by Foreign Banks in Australia



Total Resident Assets held by Foreign Banks in Australia Predictions

Actual
Predicted



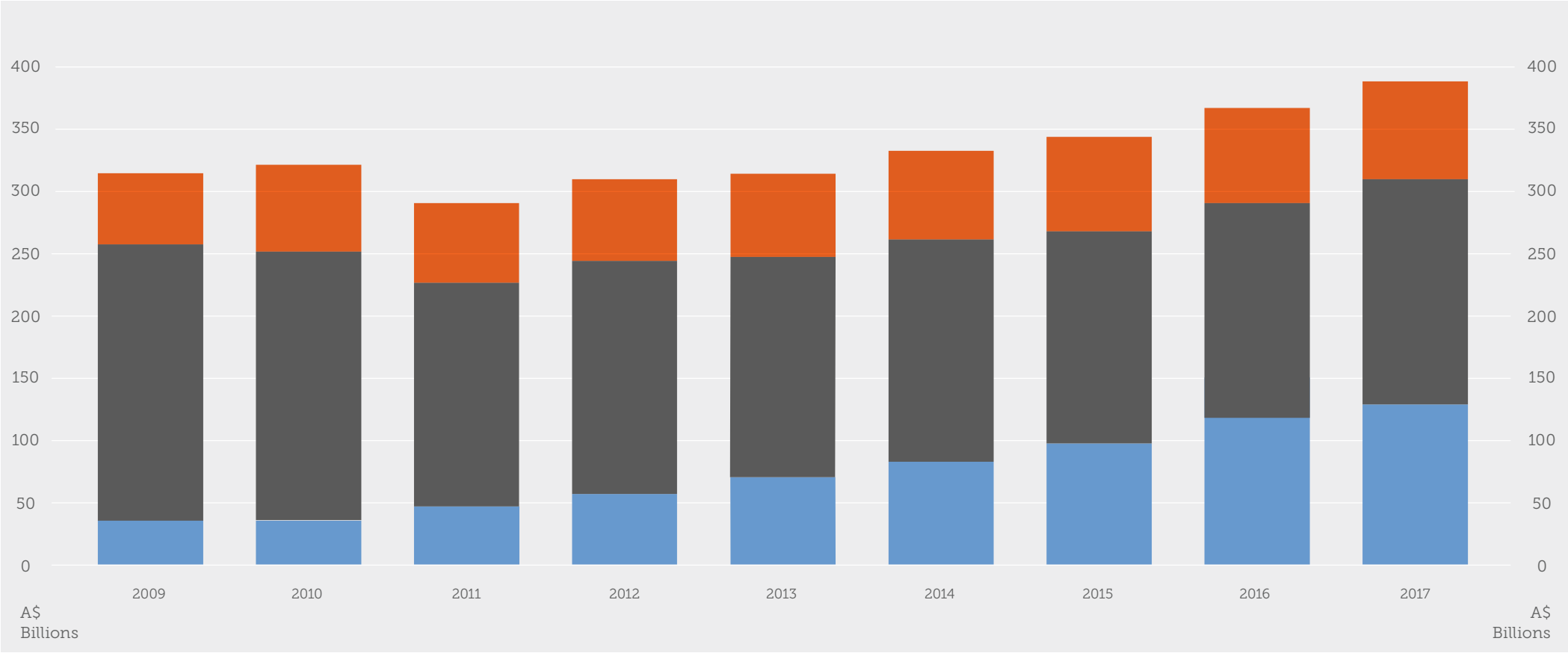
Foreign Bank Resident Assets

There has been largely positive growth for foreign banks over the last nine years, though it is clear Asian banks have the biggest story to tell – almost tripling their volume of resident assets since 2009. Our analysis shows that European banks have retreated almost 20%.

Change in volume of resident assets 2009 v 2017:

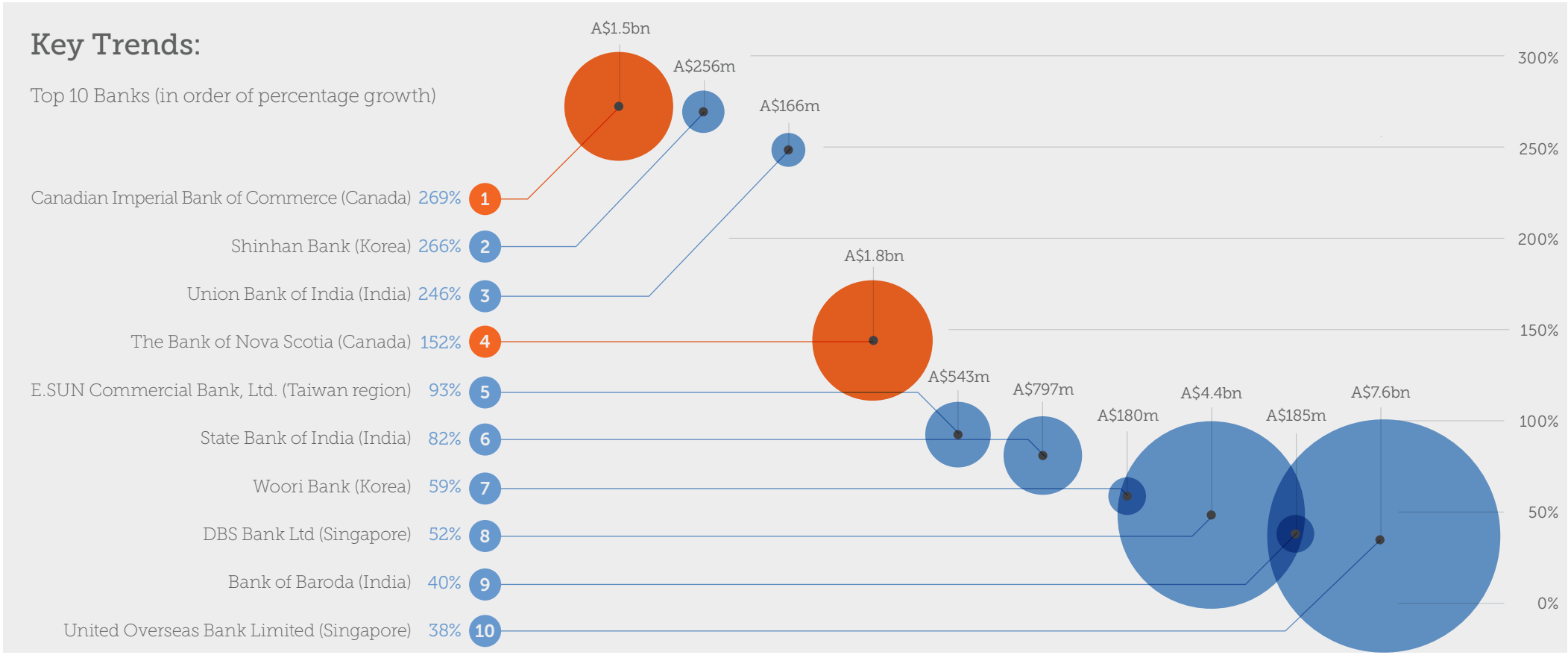
Asian banks	European banks	US & Canadian banks
274%	-18%	36%

Total Resident Assets Held by Foreign Banks



Resident Asset Growth in 2017
Top 10 Banks

This diagram illustrates the top 10 fastest growing foreign banks in order of percentage growth, with the circle depicting the size of resident assets held. It reveals particularly strong performances from two Singaporean banks: DBS Bank and United Overseas Bank, who hold the largest volume of resident assets in this picture. Once again, Asian banks come out on top, comprising eight of the top 10 – the other two banks being Canadian.



Profit Analysis: Return on Equity

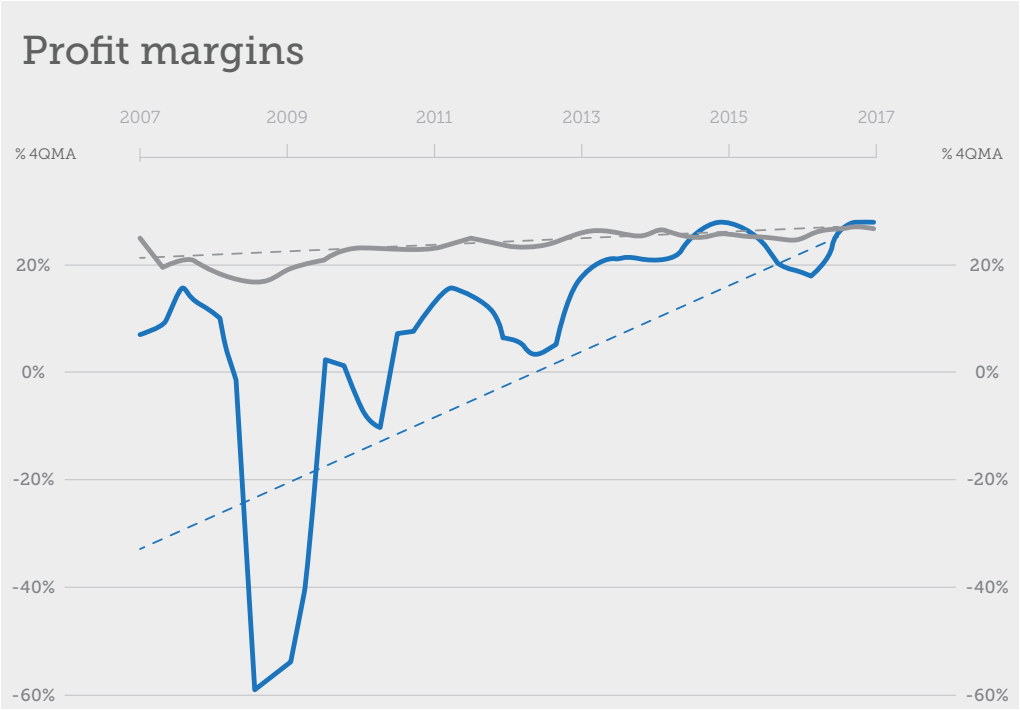
Foreign branch banks
Foreign subsidiary banks

4QMA = four quarter moving average

Insights:

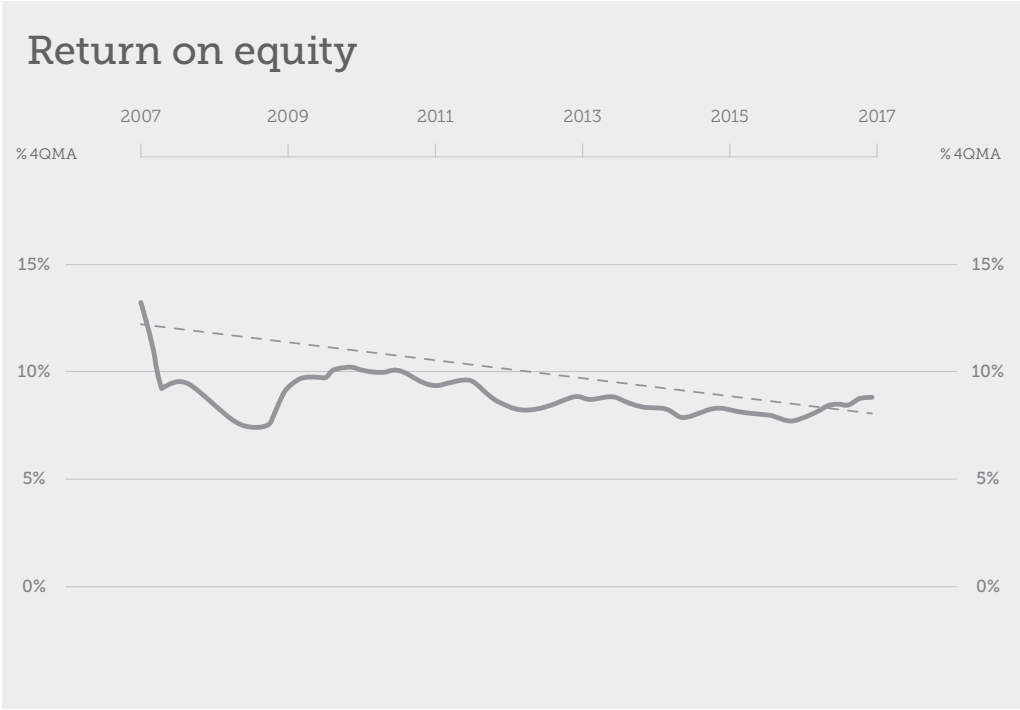
- Foreign bank branches focus on wholesale banking operations to help them access global markets
- Bank branches are less restricted by large exposures, enabling them to meet more demanding client requests
- Subsidiaries typically focus more heavily on retail banking services, to avoid large exposure
- Subsidiaries rely more heavily on local retail deposits to provide capital for lending.
  [Source: Reserve Bank of Australia (RBA)].

This chart depicts profit margins of foreign branch banks and their subsidiaries:



- The difference in these business operation models could partly explain why foreign branch profits have fluctuated so dramatically (particularly after the global financial crisis) over a 10 year period, while subsidiaries were able to maintain stability
- According to the Reserve Banks of Australia's (RBA) Financial Stability Review, "Higher capital levels directly reduce return on equity (ROE) because the share of equity funding is greater for a given return on assets. The decline in leverage of Australian banks has therefore contributed to a fall in ROE of late, which has been compounded by lower profits due to a decline in income and an increase in bad debt charges" We believe the declining ROE has been further impacted by inflation.

This graph shows a gradual decline in ROE:



(Source: APRA – "Some Features of The Australian Banking Industry"

Key Findings
Asia



Australia is seeing the effects of China's capital controls and increased scrutiny on foreign currency transactions



YOY growth of Australian resident assets among Asian banks fell from 22% to 8%



Despite the decline, the total value of resident assets still showed healthy growth, increasing from A$119 billion to A$128.5 billion

4

New Asian banks commenced operations in Australia – China Merchants Bank, Bank of Taiwan, Taishin International Bank Co., Ltd and Norinchukin Bank

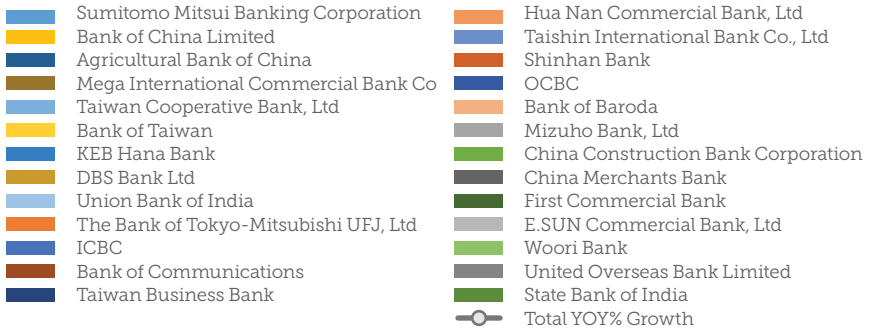


Japan experiences first negative growth since 2003, however still opens a new bank - Norinchukin Bank Australia



There are now a total of 26 Asian banks operating in Australia

Asian Banks:
Total Resident Asset Value and YOY% Growth



In this section, we cover all Asian banks reporting to APRA since 2009, namely Greater China (including Taiwan), Japan, Singapore, India and South Korea. This includes new entrants, exits and changes in resident asset volume and YOY% growth.

There is a high level of activity in this market which consistently shows strong and positive annual growth. While YOY growth seems to fluctuate widely in this graph, the compound annual graph [on page 5] shows that Asian banks have reached more sustainable growth levels as their volume of resident assets continues to build over time.

Key Trends:



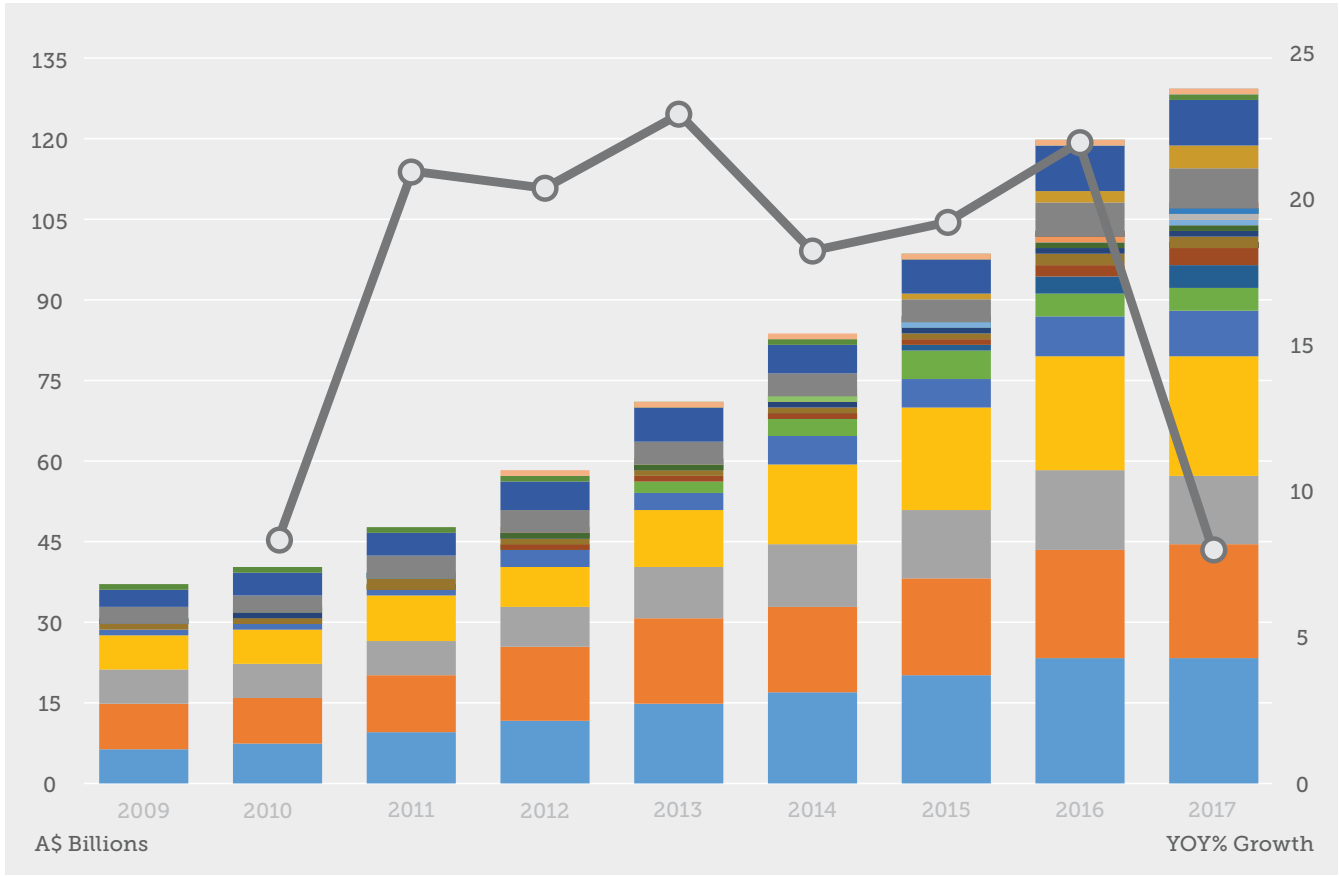
YOY% growth of Asian banks sharply decreases to 8% in 2017 (from 22% in 2016)



The total resident asset value for this region increases to AUD128.5 billion (from A$119 billion)



The overall growth trend is consistently strong and positive.



Greater China

Top Australian investment sectors for China



Commercial real estate



Healthcare



Infrastructure projects



One new bank entrant from Mainland China: China Merchants Bank

37%

Banks from Greater China account for 37% of the total resident asset value held by Asian banks in Australia



Two new bank entrants from Taiwan: Bank of Taiwan and Taishin International Bank Co., Ltd



Consumption is expected to overtake investment as the largest contributor to mainland China's GDP growth

14

The total number of banks from Greater China



Mainland China

Commentary

- Rationalisation of outbound investment is stabilising growth
- More focused investment in resource projects
- Greater scrutiny on outbound investment activities, including debt funded transactions
- Shifting landscape of Australia's foreign investment regime and posturing towards China has increased wariness
- The current growth rate is likely to be far more sustainable with real growth continuing to be healthy. The same is true of the Chinese economy overall and the nation's approach to outbound investment.

Key Trends:

6.9%

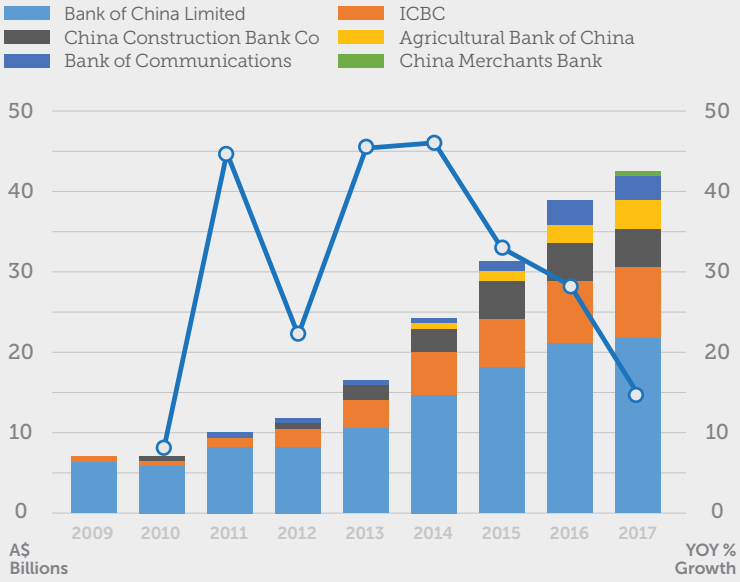
GDP growth for the 2017 year picked up to 6.9% YOY - the first annual acceleration for the economy since 2010

Declining YOY% growth is consistent with overall Chinese Outbound Direct Investment (ODI) shift during past 18 months

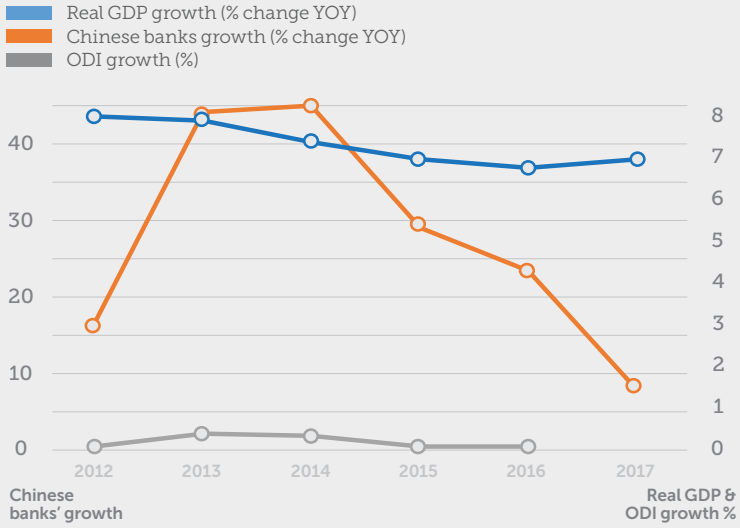
Despite the falling growth rate, Chinese banks' resident asset value still increased

The addition of *China Merchants Bank* brings the total number of mainland Chinese banks operating in Australia to six.

Mainland China Banks: Total resident asset value vs. growth



Mainland China: Real GDP / ODI / Chinese banks' (YOY% growth)



Taiwan

Commentary

Although much smaller than the banks from mainland China, it remains encouraging that Taiwanese banks are increasing in number and assets held in Australia. The overall importance of Greater China continues to grow in many sectors.

Key Trends:

32%

The YOY% growth of resident assets for Taiwanese Banks dropped to 32% in 2017 (from 65% in 2016)

While a short drop from the previous year, it still represents a rapid expansion of footprint

A$ 6.5 BN

Resident asset value increased to A$6.5 billion (from A$4.9 billion)

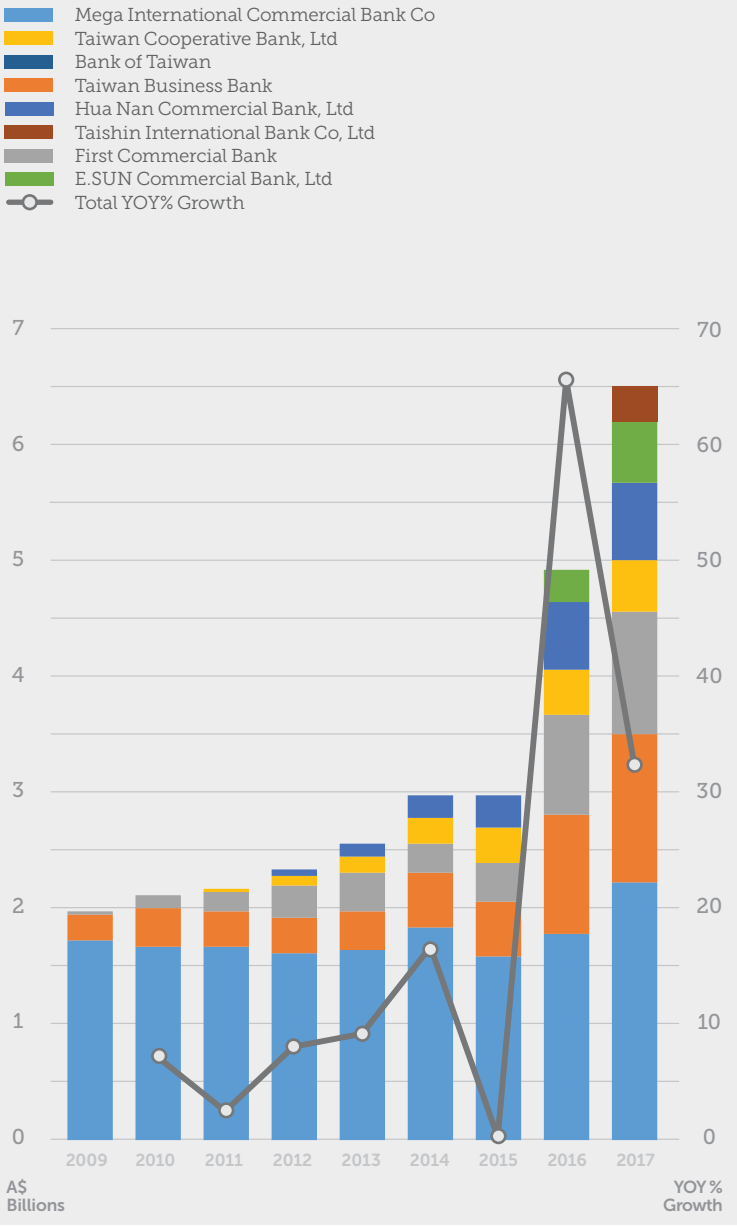
New entrants: Bank of Taiwan and Taishin International Bank

8

There are now eight Taiwanese banks operating in Australia.

Taiwan Banks:

Total resident asset value and YOY% growth



Japan

The three main Japanese megabanks remain focused on lending. Their current focus is on large-scale project finance

SMBC has an impressive record supporting some of Australia's largest and best-known projects as a lead project financier

Norinchukin Australia Profile

- Specialises in the agriculture, fisheries and forestry sectors
- Primary purpose to explore project finance and asset finance opportunities in Australia and New Zealand
- One of Japan's largest institutional investors with an investment portfolio of more than US$540 billion and assets exceeding US$950 billion.

Commentary

Japanese banks, such as new entrant Norinchukin Bank, are seeking investment returns out of Japan due to the ongoing low interest rate environment. Although Japanese banks may have faced negative growth in Australia, it is still an attractive investment destination compared to zero/negative interest rates in Japan.

In Japan, there remains optimism that the current Abe government is performing well and the economy will grow moderately (particularly after the Liberal Democratic Party of Japan was returned with a strong majority in parliamentary elections last year. Abe is now the third longest serving Japanese Prime Minister).

However, it will be some time before inflation will lift to the Bank of Japan's (BoJ) 2% target (the target date was revised last year to 2020). Around the world, central banks have pulled back on quantitative easing (QE) and so has the BoJ. Richard Koo, the chief economist for Nomura Research Institute, calls Japan's experience a "balance sheet" recession. This meaning Japanese firms have spent the last decades repairing their balance sheets and have a nervousness of investing even with expansive monetary policy – thus acting as a dampener on the effectiveness of QE as a driver for growth.

The activities of the three Japanese megabanks in Australia (Sumitomo Mitsui Banking Corporation, Mizuho and MUFJ) remain focused on lending activities - providing financing for transactions not just to Japanese clients. They have been quite successful in competing in the broader market. Their current focus is primarily on large-scale project finance.

Key Trends:

-1.2%

The YOY% growth of resident assets for Japanese banks dropped to -1.2% in 2017 (from 13% in 2016)

A$ 57.2 BN

The total resident asset value dropped slightly to A$57.2 billion (from A$59.9 billion)

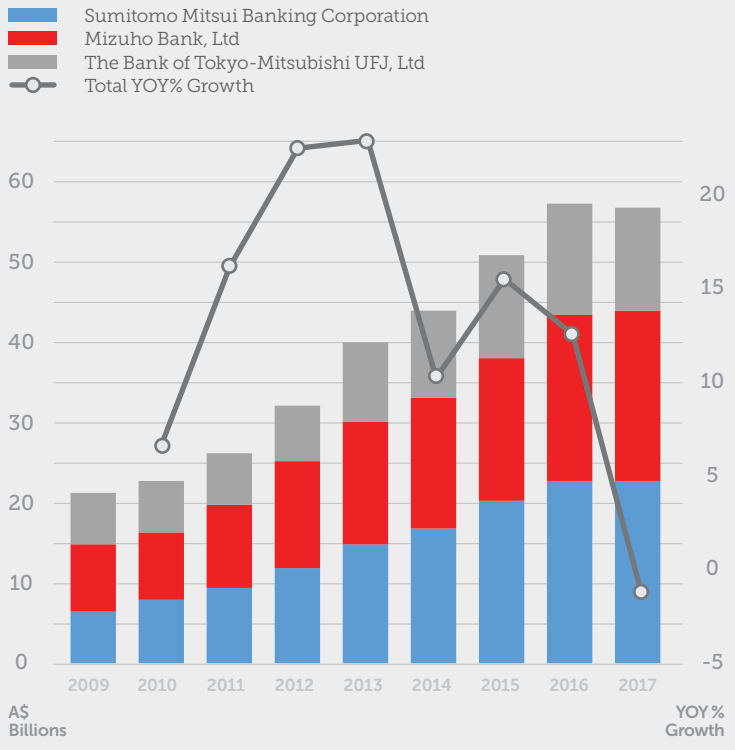
This is Japan's first recorded negative growth in Australia since 2003

Despite negative growth, a new Japanese bank entered into the Australian market in 2017 - Norinchukin Bank

The last Japanese bank to enter Australia was SMBC in 2006.

Japan Banks:

Total resident asset value and YOY% growth



* No data available for Norinchukin as at 31 Dec 2017.



Singapore

Singapore is currently investing significantly in Australian infrastructure, energy, commercial property and hospitality. Some key Singaporean bank deals in the past year include:

- **Oversea-Chinese Banking Corporation (OCBC)** acquiring the private wealth business of National Australia Bank Limited in Singapore and Hong Kong
- **DBS Bank** and **United Overseas Bank** (along with other banks) in the syndicated financing of two energy sector acquisitions:
  - Alinta Energy's acquisition of Loy Yang B Power Station
  - NSW Electricity Networks consortium's acquisition of TransGrid from the Government of New South Wales.
- **DBS Bank** in the syndicated financing of two windfarm acquisitions by *Powering Australian Renewables Fund* from AGL Energy.

Areas of focus

- Healthcare
- Real Estate Investment Trusts
- Commercial property
- Energy

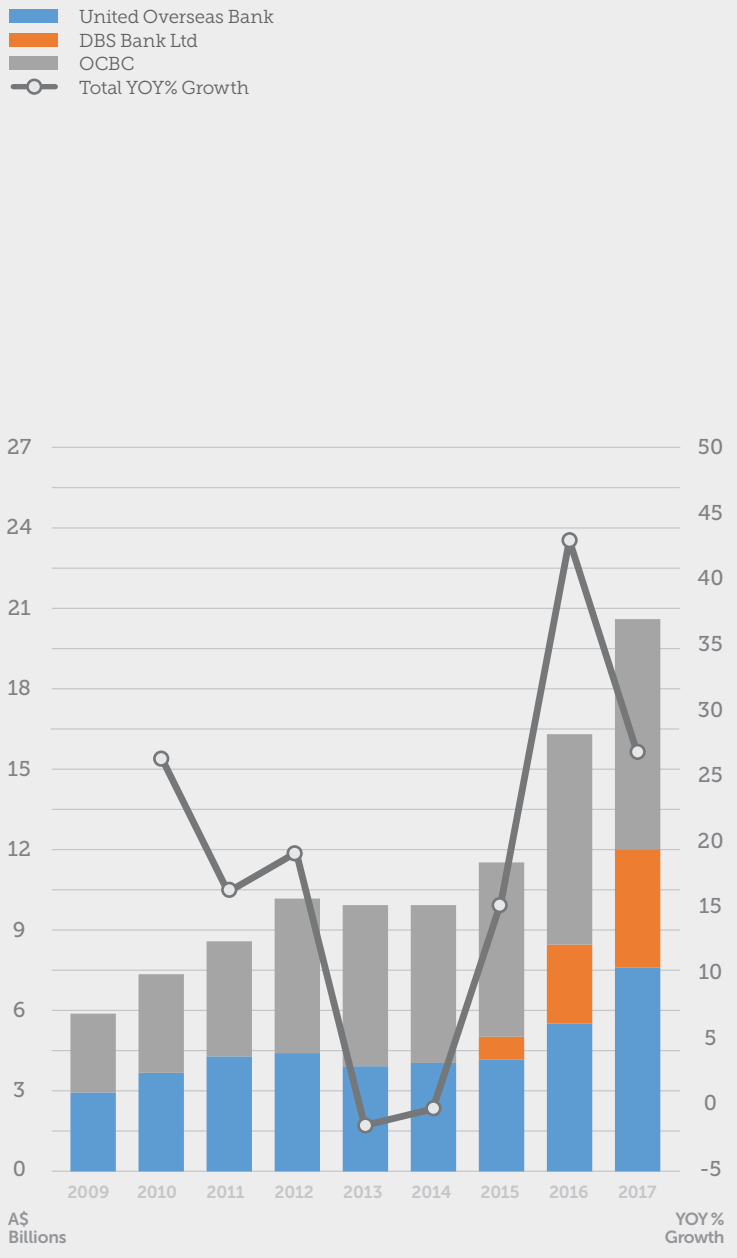
Key Trends:

26% The YOY% growth of resident assets for Singapore banks dropped to 26% in 2017 (from 42% in 2016)

A$ 21 BN The total resident asset value still increased to A$21 billion in 2017 (from A$16 billion in 2016).

Singapore Banks:

Total resident asset value and YOY% growth





India

Key Trends:

85% ↑

The YOY% growth of resident asset for Indian banks increased to 85% in 2017 (from 34% in 2016)

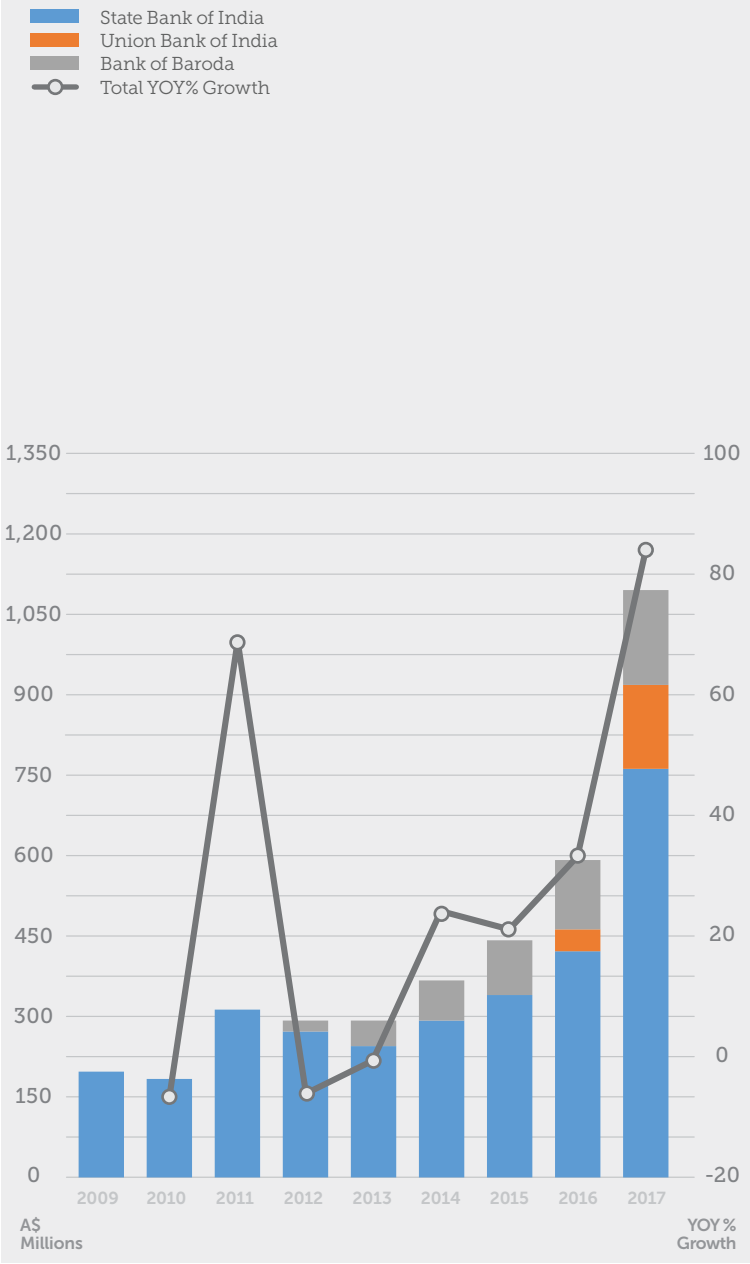
A$ 1.1 BN

The total resident asset value also increased significantly to A$1.1 billion in 2017 (from A$619 million in 2016).

We will continue to watch Indian banks' performance with interest as they build on resident assets and take more significant steps to establish a foothold in Australia.

India Banks:

Total resident asset value and YOY% growth





South Korea

A$23 BN

invested in Australia

Key Trends:

41% ↓

The YOY% growth of resident assets for South Korean Banks declined to 41% in 2017 (from 78% in 2016)

A$ 891 M

The total resident asset value increased to A$891 million (from A$633 million).

Commentary

The outlook for South Korea is a positive one. South Korea's GDP growth has consistently outperformed advanced economies and we believe it will continue to do so. The government is in a budgetary position coveted by many developed and developing economies and its structural fiscal balance is healthier than many advanced economies.

Analysis by the International Monetary Fund concludes South Korea is in a very strong financial position. Key indicators of capital adequacy, liquidity and asset quality of banks and non-bank financial institutions are positive.

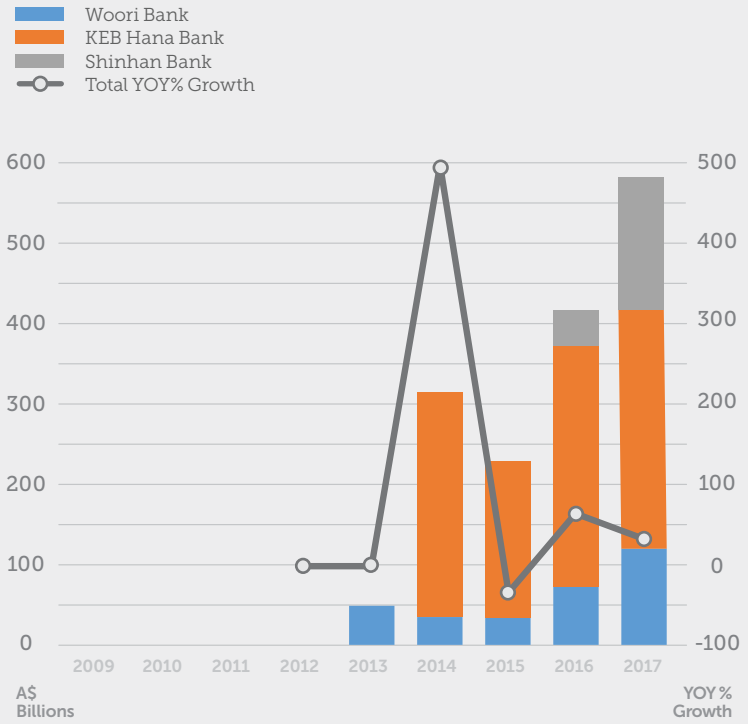
South Korea's economy and financial markets have proved resilient to the region's well-known geo-political risks.

South Korea's direct investment in Australia has jumped to A$23 billion and is growing 60% faster than Australia's other investment partners. Major Korean institutions have developed a significant Australian investment portfolio. Some Korean institutions, including Export Import Bank of Korea, Korea Development Bank and Hyundai Capital Services, have issued A$5.3 billion of "kangaroo" bonds since 2013, which is facilitating investment from global investors.

The three Korean banks (KEB Hana Bank, Woori Bank and Shinhan Bank) along with state-owned Korea Development Bank, are active on various lending activities and provide financing for transactions beyond Korean borrowers. Their current strategy involves actively exploring opportunities on large-scale syndicated project finance.

South Korean Banks:

Total resident asset value and YOY% growth



Key Findings
Europe



There are eight European banks currently active in Australia compared with 13 in 2009



After many years of retrenchment triggered by the global financial crisis, there are signs of recovery among European banks, experiencing two years of consecutive growth for the first time since 2005

6%

Significantly, YOY growth at 6% saw European banks perform almost as strongly as Asian banks

+A$10.6BN

Combined resident asset value of European banks increased by A$10.6 billion



ING Bank holds the lion's share of resident assets of all foreign banks.



Europe

Commentary

European banks reduced their exposure to the Australian market following the global financial crisis, with the aim of focussing on matters closer to home.

However, as the European economy has recovered, the banks have refocussed on the Australian market, leading to YOY growth for the past two years.

At this stage, there has been no appreciable adverse impact from Brexit, notwithstanding ongoing uncertainty as to how this will take shape.



ING Bank's customer numbers surged by 36% to 1.7 million due to a record take-up of its Orange Everyday payment account



ING Bank is the fifth-largest retail bank in both household balances and mortgages in Australia

(Source: AFR 17 March 2017)

Key Trends:

6% ↑

The YOY growth of European banks increased to 6% in 2017 (from 0% in 2016)

A$ 183.6 BN

The total resident asset value for this region increased to A$183.6 billion in 2017 (from A$173 billion in 2016)

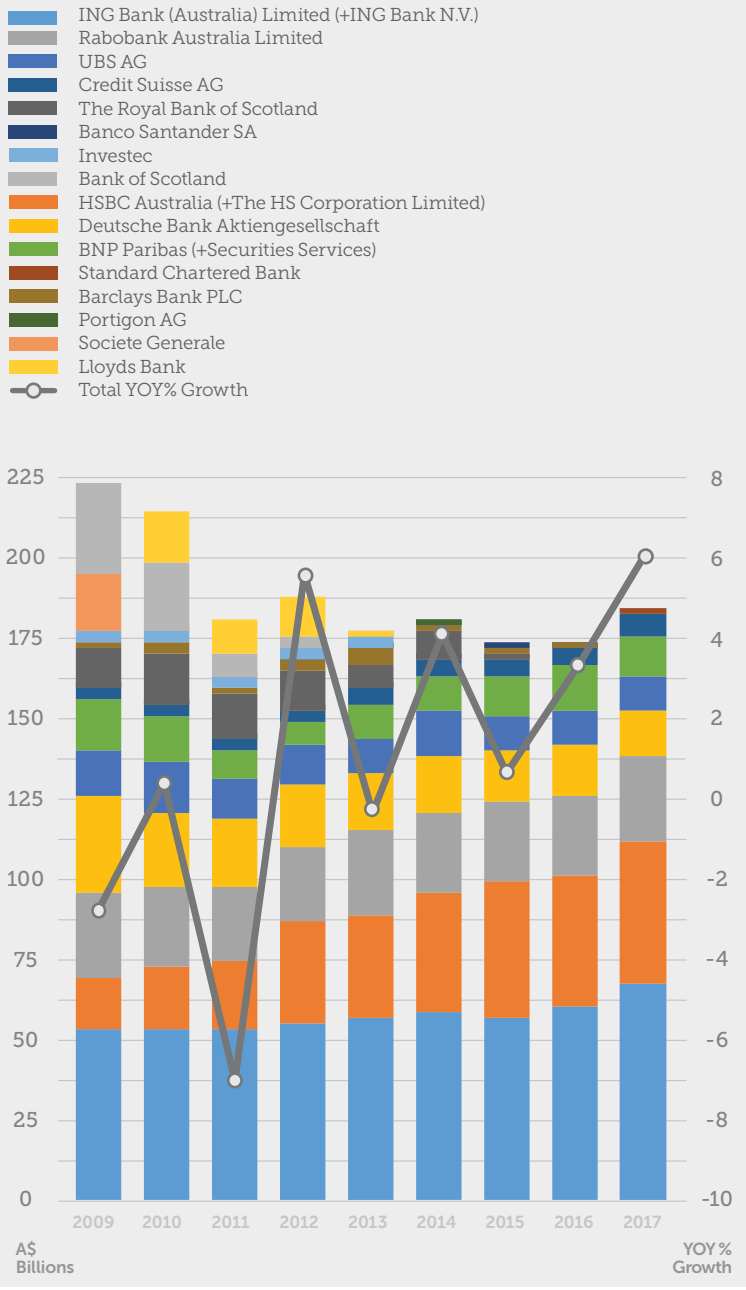
This is the first time European banks have experienced two consecutive years of growth since 2005

A$ 67 BN

ING Bank contributes to the majority of this growth, increasing its resident assets to A$67 billion (from A$61 billion).

Europe Banks:

Total resident asset value and YOY% growth



Key Findings
US & Canada



Canadian banks recorded strong growth, increasing volume of resident assets to $9.3 billion (from A$5.7 billion)

63%

The total YOY% growth of resident assets among Canadian banks increased by 63%



The establishment of Export Development Canada and Canada Pension Plan Investment Board in Australia is a positive sign of the region's intent to build a long-term investment strategy

-3%

US banks dragged the region's performance down, recording negative growth of -3% (from 0.5% in the previous year).



US & Canada

Key Trends:

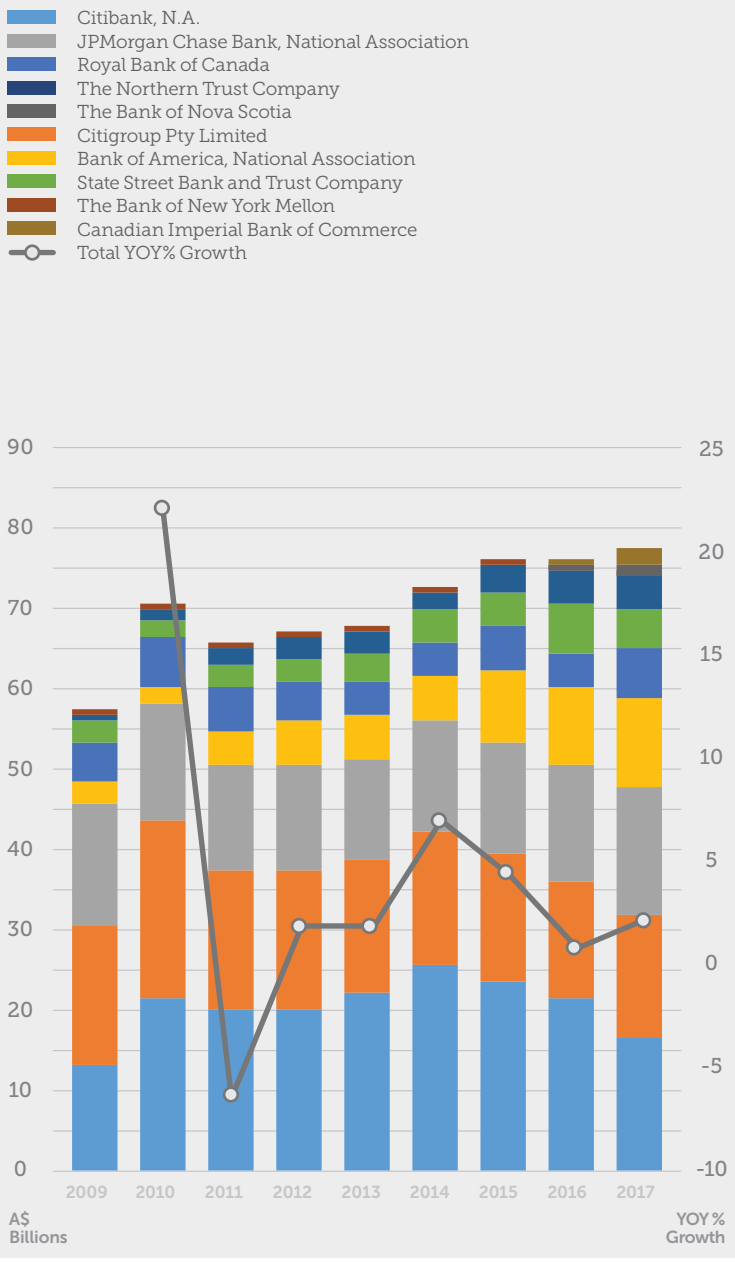
2% ↑

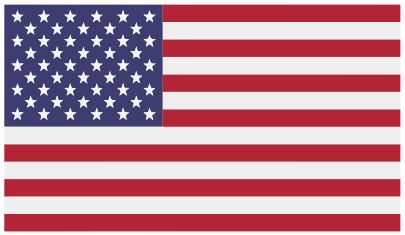
The combined YOY% growth of American and Canadian banks increased to 2% in 2017 (from 0.76% in 2016)

A$ 77.9 BN

The total resident asset value for this region increased to A$77.9 billion (from A$76 billion).

US & Canadian Banks:
Total resident asset value and YOY% growth





US

Key Trends:

-3%

The YOY% growth of American banks declined to -3% in 2017 from 0.5% in 2016

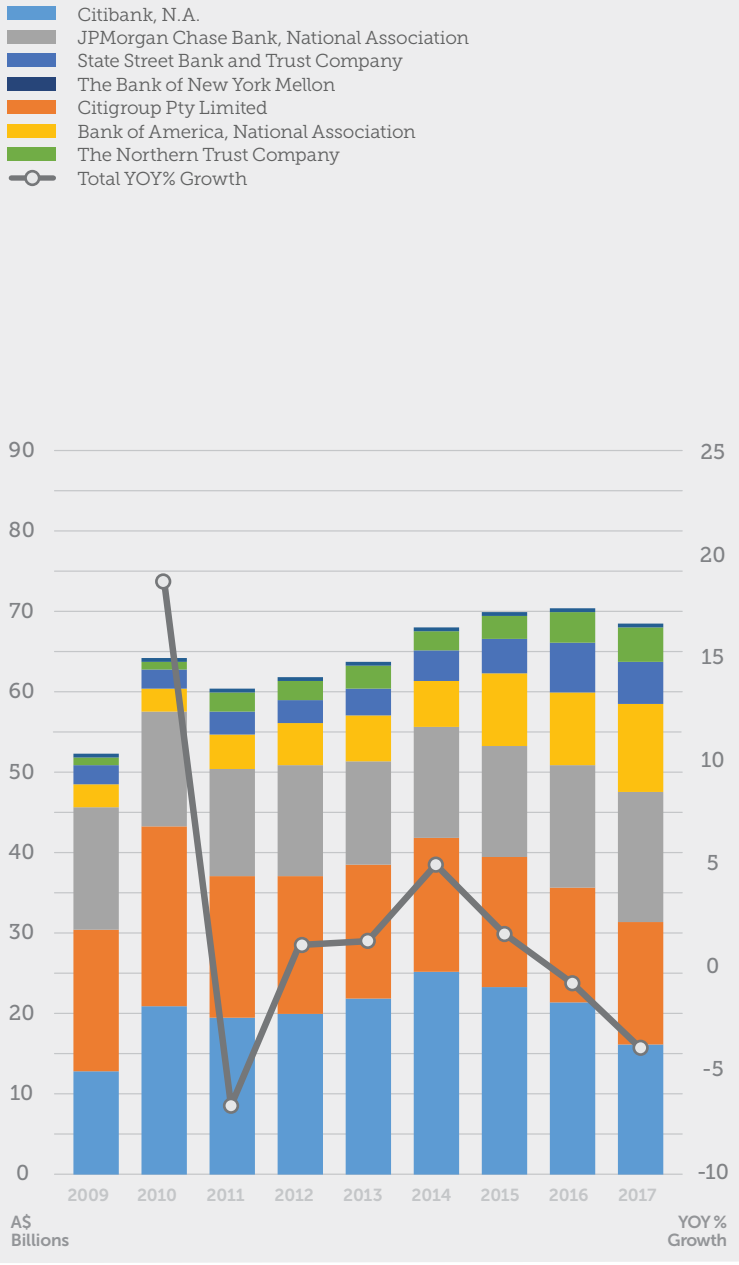
This is the third consecutive year of decline in YOY% growth

$A 68.2 BN

The total resident asset value for this region declined to A$68.2 billion (from A$70.3 billion).

US Banks:

Total resident asset value and YOY% growth





Canada

C$7.9 billion invested in Australia during 2017.



The Canada Pension Plan Investment Board (CPPIB) has established a stand-alone office in Sydney. They currently hold $10.9 billion in real estate assets in Australia – including commercial, industrial and residential estates.



(Source: CPPIB news release)



The Canadian Imperial Bank of Commerce and the Bank of Nova Scotia were among the five fastest growing banks in the past year.



Export Development Canada (EDC), a Canadian export agency, established an Australian office in 2017. It aims to double the value of loans and insurance it provides to Canadian-backed projects in Australia over the next three years.

Key Trends:



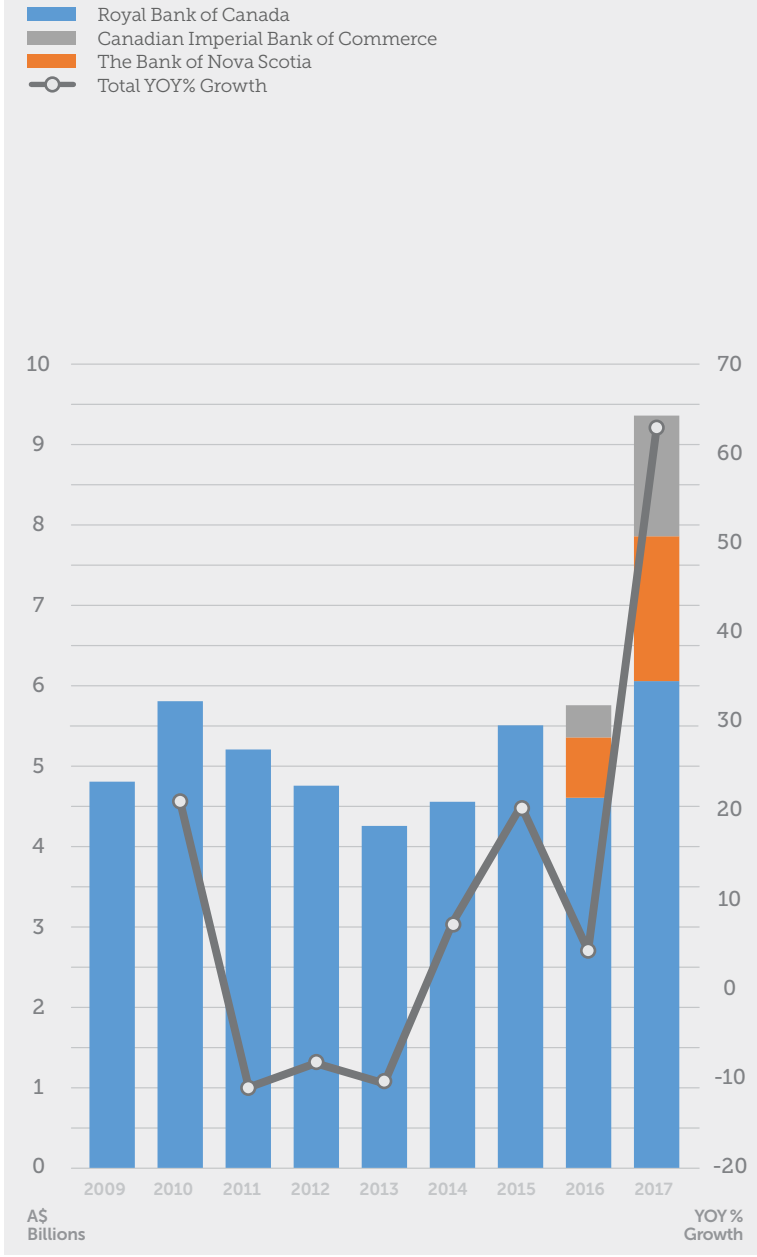
The YOY% growth of Canadian banks increased to 63% in 2017 (from 4% in 2016)



The total resident asset value for Canadian banks increased to A$9.3 billion in 2017 (from A$5.7 billion in 2016).

Canada Banks:

Total resident asset value and YOY% growth



About this report

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Each year, MinterEllison's Foreign Bank Tracker provides insights and key trends on the growth rates of resident assets held by foreign branch and subsidiary banks in Australia.

Our insights are based on data from the Australian Prudential Regulatory Authority (APRA) which assesses the size of foreign bank loan books across three regions – Asia, Europe and US/Canada.

This is the third annual report to be released by MinterEllison, and is considered a vital reference for participants in the local and international financial services markets.

We are pleased to present the findings for our 2018 report in a review of data covering 31 December 2009 – 31 December 2017. Some details on our data are as follows:

- The term "total resident assets" has been used throughout this report. It refers to all assets on the banks' domestic books that are due from residents. Put simply, it shows the value of assets the foreign banks hold in Australia.
- "Resident assets" refers to all assets on the banks' domestic books. Unless otherwise stated, the statistics analysed relate to the operations/transactions conducted with residents that are recorded on the domestic books of licensed banks. The data is intended to provide information on the banking activity of individual banks within our domestic market.
- The domestic books of a bank has the following scope:
  - includes operations/transactions booked or recorded inside Australia;
  - does not consolidate Australian or offshore controlled entities;
  - includes transactions of Australian-based offshore banking units;
  - excludes transactions of overseas-based offshore banking units;
  - excludes offshore branches; and
  - excludes transactions, assets and liabilities with offshore branches.
- For the purpose of this report, we have listed Taiwanese banks on a separate slide as a part of the Greater China section.



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