# Box C: Foreign-owned Banks in Australia

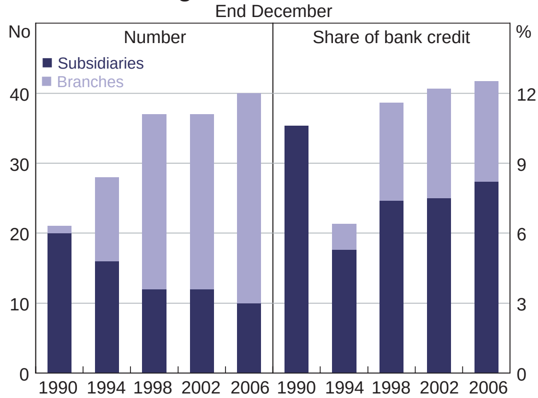
Prior to 1985, foreign-owned banks had only a limited involvement in the Australian banking system, with just two foreign institutions operating continuously as authorised banks in the post-war period.[1] This situation reflected a moratorium on foreign-bank entry that had effectively been in place during this period. Despite this restriction, foreign banks did participate in the Australian financial system, mainly through wholly owned or part-owned merchant banks, with the merchant banking sector accounting for around 5 per cent of the total assets of financial intermediaries in Australia in the 1970s. The relaxation of foreign-bank entry restrictions announced in 1984 led to the granting of bank licenses to 15 overseas banks over the next year and a half – some to existing merchant banks and some to genuinely new bank entrants. One feature of the entry requirements was that foreign banks assumed subsidiary status rather than a branch structure, thus requiring capital to be held locally.

The early entrants generally struggled, however, to make meaningful inroads into the market shares of the incumbent banks, particularly in retail banking. When conditions on foreign bank entry were further liberalised in 1992, foreign banks were permitted to operate as a branch or as a subsidiary. If the bank operates as a branch, capital is not held locally and the bank is not permitted to accept retail deposits from Australian residents of less than $250 000. Since the mid 1990s, the branch structure has become more prominent among foreign banks. Currently, 40 of the 54 Australian banking licences are held by foreign banks, with 30 of these operating as branches; some foreign banks have both a branch and a subsidiary in Australia (Graph C1). In contrast to the previous period, the foreign-owned banks' share of total domestic lending has increased noticeably over the past decade or so – from around 7 per cent of bank credit in 1994, to around 13 per cent at the end of 2006. This reflects a combination of acquisitions, new entrants and organic growth.

**Graph C1**

**Foreign Banks in Australia**

End December




Sources: APRA; RBA

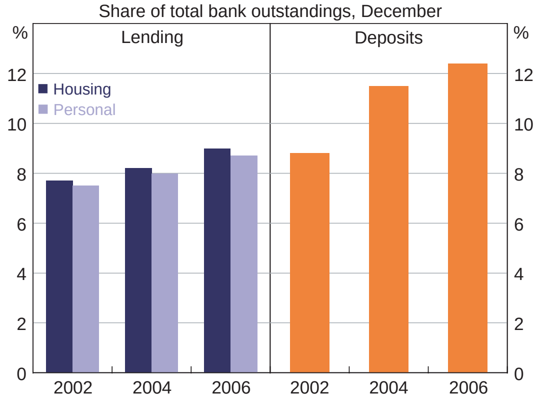
This increase in market share partly reflects a renewed focus on retail banking by foreign-owned banks over the past five or so years, which has been facilitated by the more widespread distribution of banking services via the internet. It is estimated that the number of

1 *The Bank of New Zealand and Banque Nationale de Paris. The Bank of China also operated as a branch up to 1972, re-opening in 1985. For more details, see Edey, M. and B. Gray (1996), 'The Evolving Structure of the Australian Financial System'*, Reserve Bank Research Discussion Paper 9605.

Graph C2

Foreign Banks' Household Market Shares

Share of total bank outstandings, December




Source: APRA

people banking online in Australia has increased at an average annual rate of 18 per cent in recent years, which has helped foreign-owned banks overcome the disadvantage of having small branch networks.[2] Most notably, foreign-owned banks were among the first institutions to offer high-yield online savings accounts, beginning in the late 1990s. Reflecting this, these banks currently hold around 12½ per cent of households' total bank deposits, compared to just under 9 per cent in 2002 (Graph C2). The rate of increase has, however, slowed over the past couple of years as an increasing number of other deposit-takers have responded by offering similar products.

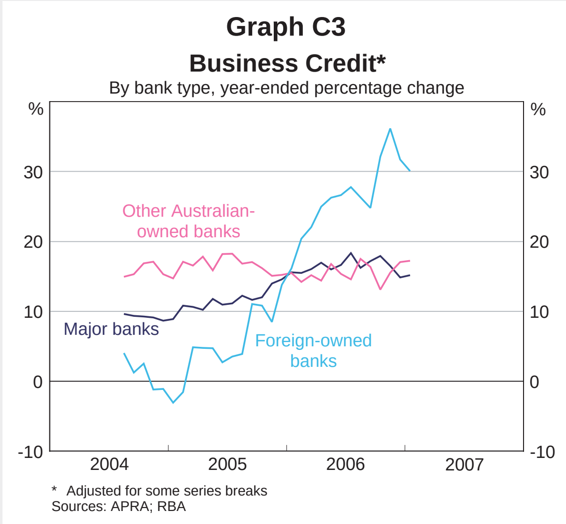
Foreign-owned banks have also increased their lending to the household sector at an above-average rate recently, though the gains in market share have been less pronounced than in the deposit market. These banks currently account for around 9 per cent of both total bank housing and personal loans outstanding.

In the housing loan market, at least two related factors appear to have contributed to this increase. The first is that the small existing portfolios of most foreign-owned banks has meant that they are able to advertise lower interest rates without adversely affecting the profitability of a large stock of loans to existing customers. The second is the wider acceptance on the part of customers of applying for loans over the internet, which has increased the ability of these banks to reach new borrowers. In personal lending, foreign-owned banks are most active in the credit card market, accounting for around 12 per cent of banks' domestic credit card balances outstanding. This share has increased from around 8 per cent five years ago, with a number of these banks focusing in particular on the low-rate/no-frills segment of the credit card market.

Despite the recent advances in retail banking, foreign-owned banks still have a larger presence in the business banking market, reflecting the focus of foreign bank branches on wholesale operations. At end 2006, foreign-owned banks accounted for around 18 per cent of total bank business credit outstanding. Business credit extended by these banks has grown very rapidly over the past 18 months, reaching an annual growth rate of over 35 per cent in late 2006, compared to around 16 per cent for Australian-owned banks (Graph C3). This recent strong performance has brought foreign-owned banks' market share back to around its 2002 level, after

2 *See Department of Communications, Information Technology and the Arts (2005),* Trust and Growth in the Online Environment, *page 13.*

their business lending had grown at a below-average rate in the intervening period.




Much of the pick-up in foreign-owned banks' business lending growth has been in 'large' loans (defined as loans over $2 million), with these banks accounting for around one quarter of outstanding bank loans of this size. The activity of foreign-owned banks appears to have been one of the catalysts for stronger competition in this market, which in turn has been associated with a contraction in lending margins. Foreign-owned banks operating in Australia (as well as foreign banks located offshore) are also prominent in the market for syndicated loans, accounting for around one third of syndicated loan approvals in Australia in recent years, with part of this activity associated with the surge in leveraged buyouts over the past year. ✠