

### Research Update:

# Australia & New Zealand Banking Group Ltd. & Subsidiaries' Ratings Lowered On Criteria Change

**Primary Credit Analyst:**

Gavin Gunning, Melbourne (61) 3-9631-2092;gavin\_gunning@standardandpoors.com

**Secondary Contact:**

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

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## Research Update:

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## Overview

- Following a review under Standard & Poor's revised bank criteria (published Nov. 9, 2011), we have lowered our long-term issuer credit rating on Australia and New Zealand Banking Group Ltd. (ANZ) to 'AA-' from 'AA'. The 'A-1+' short-term rating is affirmed. The outlook is stable.
- Our ratings on subsidiaries of ANZ have also been lowered following our review (see Ratings List).
- Our ratings on ANZ reflect the anchor SACP for a bank operating mainly in Australia; plus the bank's strong business position, its adequate capital and earnings, risk position, and liquidity; average funding; and potential government support.
- The stable outlook reflects our expectation that: ANZ's Asian regional strategy will be well managed; risk-adjusted capital ratios will remain adequate by our standards; the risk position will not deteriorate materially or unexpectedly; and recent funding and liquidity improvements can be sustained.

## Rating Action

As previously announced, on Dec. 1, 2011, Standard & Poor's Ratings Services lowered its long-term issuer credit rating on ANZ to 'AA-'. The 'A-1+' short-term rating was affirmed. Our long-term rating on ANZ National Bank Ltd. (ANZ National), ANZ's core New Zealand banking subsidiary, has also been lowered to 'AA-'. The ratings on ANZ's insurance and wealth-management subsidiaries also have been lowered (see Ratings List). Our outlook on ANZ is stable.

Further, we have withdrawn our bank fundamental strength rating on ANZ.

## Rationale

Our ratings on ANZ reflect the anchor stand-alone credit profile (SACP) for a bank operating mainly in Australia; plus the bank's "strong" business position, its "adequate" capital and earnings, risk position, and liquidity; "average" funding; and potential government support.

Our bank criteria use the BICRA economic risk and industry risk scores to determine a bank's anchor SACP, the starting point in assigning an issuer credit rating. The anchor SACP for a bank operating only in Australia is 'a-';

ANZ conducts about 75% of its lending in its Australian home market. The BICRA score is informed by our evaluation of economic risk, where we view Australia as a wealthy, open, and resilient economy. We consider that build-up of private sector credit and asset prices has eased in the recent years, and that moderate private sector debt is offset by conservative lending practices and a creditor-supportive legal framework. With regard to industry risk, our assessment of the Australian banking industry is underpinned by the country's conservative and comprehensive regulation, and the banking sector's very low risk appetite, partly offset by limited funding support from customer deposits and a material dependence on net external borrowings. ANZ conducts about 20% of its lending in New Zealand, which has a weaker '3' economic risk score compared with Australia, and about 5% of its lending elsewhere, resulting in a weaker weighted average economic risk score but not to the extent that affects the anchor SACP we have assigned to ANZ.

The SACP for ANZ is 'a'.

In our view, ANZ's business position is "strong". As one of four major banking groups dominating the Australian and New Zealand banking sectors, ANZ's business stability benefits from the bank's diversified, deeply-embedded presence across the retail, commercial, and corporate customer segments, augmented by its good profile in asset management and insurance. ANZ's New Zealand subsidiary, ANZ National Ltd., is the largest bank in New Zealand, with an asset base approximately 1.7x larger than the average size of the other three major banks. While ANZ has a strong track record in formulating and executing strategies, we nevertheless are cautious about its expansion strategy for Asia. Noting that ANZ is targeting sourcing up to 25% of its revenues from Asia, Europe, and the U.S. by 2017, we will continue to monitor strategic developments concerning potential Asian regional expansion, in particular reconciling how it equates to our current view of the bank's business position as "strong".

We assess ANZ's capitalization and earnings as "adequate". Our expectation is that capitalization will continue to steadily improve over the next 12-18 months, potentially to the mid-to-higher end of our "adequate" range, which is 7%-10% under our ratings criteria. In our view, ANZ's forward earnings prospects are good by domestic and international standards, which should benefit internal capital generation. The good prospects are supported mainly by the bank's diversified revenue streams and good asset quality. While ANZ benefits from good-quality revenue streams, we note that the outlook for credit growth in its core home markets is relatively subdued.

We assess ANZ's risk position as "adequate". This opinion is mainly because ANZ's risks are well spread across the sectors in which it operates, and because these sectors remain in relatively good health by international standards. Furthermore, potentially higher-risk activities--including those associated with large lending exposures, commercial property development, or higher-risk sectors or borrowers are currently considered manageable. While the bank's losses following the global financial crisis were lower than many other highly-rated international banks, we note that the economic and

commercial property downturn in Australia and New Zealand was less severe than that experienced in the U.S. and Europe.

We view ANZ's funding as "average" and liquidity as "adequate". While ANZ and other Australian major banks are considered by us to be materially reliant on wholesale funding, we note that much of this risk has been taken into account by us in our recent revision of our BICRA assessment of Australia to group '2' from group '1'.

Our counterparty credit rating on ANZ is two notches higher than the SACP, reflecting our view of a high likelihood of extraordinary government support in a crisis. We believe this is due to ANZ's high systemic importance in Australia, and our assessment of the Australian government being highly supportive of institutions core to the national economy.

We have lowered the issue ratings on ANZ's non-deferrable senior subordinated debt to 'A-' from 'AA-', which is one notch below ANZ's SACP, because we believe that Australia's legal and regulatory framework could allow authorities to instigate restructuring of a failing bank to the detriment of non-deferrable subordinated debt. We have lowered the issue ratings on ANZ National's non-deferrable senior subordinated debt to 'A-' from 'AA-', which is one notch below ANZ's SACP, reflecting our view that ANZ National is a core subsidiary of ANZ. We note that the short-to-medium-term prospects for ANZ experiencing financial stress requiring a restructuring of the bank to the detriment of non-deferrable subordinated debt holders is low. We likewise have lowered the issue ratings on ANZ's hybrid capital instruments to 'BBB', which is three notches below the SACP. Under our criteria, the three-notch differential reflects the narrow-distributable-profits test that is applicable to hybrid-capital instruments issued by Australian banks.

## Outlook

The stable outlook reflects our view that the ratings are likely to remain unchanged over the next one-to-two years. To maintain the stable outlook, we expect that ANZ's Asian regional strategy will be well managed and not detract from the bank's strong credit standing. Furthermore, we expect that: the risk-adjusted capital ratios will remain consistent with our view that they are adequate; the risk position will not deteriorate materially or unexpectedly; and that recent funding improvements, including the steady transition to improved deposit levels and longer-tenor wholesale funding, can be sustained.

We currently believe that prospects of positive ratings momentum in the short-to-medium-term are unlikely. That said, we believe that ANZ ultimately has the potential to achieve higher capitalization, and should that occur, we could raise the ratings. We would have to be comfortable, however, that ANZ could achieve a risk-adjusted capitalization of greater than 10% on an ongoing basis.

The ratings could be lowered if our view of ANZ's funding compared to domestic

peers' weakens; or potentially if the peer group as a whole deteriorates. We believe the prospects of ANZ's funding deviating negatively from broad peer averages is unlikely, considering ANZ's commitment to funding improvements over recent years, including reduced reliance on short-term wholesale funding, and improved deposit levels (even if partly because of lower lending growth).

Nonetheless, the rating could be lowered if our view of ANZ's funding or liquidity weakens, whether due to the knock-on effects of volatile global debt markets because of euro-zone stresses, or potentially other factors. While we have limited tolerance at the current rating level for a material or unexpected deterioration in asset quality or earnings, a minor drop in key asset quality or earnings measures is not likely to cause us concern, considering that these metrics remain good by domestic and international standards.

The ratings would also come under pressure should the sovereign rating on Australia be lowered, as that would possibly impact the level of government support factored into the counterparty credit rating on ANZ. In our view, this is an unlikely scenario in the short-to-medium term.

## Ratings Score Snapshot

Issuer credit rating	AA-/Stable/A-1+
SACP	a
Anchor	a-
Business position	Strong (1)
Capital and earnings	Adequate (0)
Risk position	Adequate (0)
Funding and liquidity	Average and adequate (0)
Support	+2
GRE support	0
Group support	0
Sovereign support	+2
Additional factors	0

## Ratings List

Downgraded	To	From
Australia and New Zealand Banking Group Ltd. Certificate of deposit Local currency	AA-	AA
ANZ National Bank Ltd. Certificate of deposit Foreign currency	AA-	AA
Esanda Finance Corp. Ltd.		

*Research Update: Australia & New Zealand Banking Group Ltd. & Subsidiaries' Ratings Lowered On Criteria Change*

Issuer credit rating	AA-/Stable/A-1+	AA/Stable/A-1+
OnePath Australia Ltd.		
Issuer credit rating		
Local currency	A+/Stable/A-1	AA-/Stable/A-1+
OnePath Life Ltd.		
Issuer credit rating		
Local currency	AA-/Stable/--	AA/Stable/--
Financial strength rating		
Local currency	AA-/Stable/--	AA/Stable/--
Australia and New Zealand Banking Group Ltd.		
Senior unsecured (277 issues)	AA-	AA
Subordinated (23 issues)	A-	AA-
Junior subordinated (1 issue)	BBB	A+
Preferred stock (1 issue)	BBB	A+
Preference stock (2 issues)	BBB	A+
Preferred stock convertible (1 issue)	BBB	A+
Certificate of deposit (1 issue)	AA-	AA
ANZ National (Int'l) Ltd.		
Senior unsecured (28 issues)	AA-	AA
ANZ National Bank Ltd.		
Senior unsecured (10 issues)	AA-	AA
Subordinated (3 issues)	A-	AA-
Subordinated (1 issue)	BBB	A+
Certificate of deposit (1 issue)	AA-	AA
UDC Finance Ltd.		
Senior secured (1 issue)	AA-	AA
Subordinated (1 issue)	A-	AA-
Esanda Finance Corporation Ltd.		
Senior Unsecured	AA-	AA
Australia and New Zealand Banking Group Ltd.		
ANZ National Bank Ltd.		
Issuer credit rating	AA-/Stable/A-1+	AA/Stable/A-1+
Australia and New Zealand Banking Group Ltd.		
Certificate of deposit		
Foreign currency	AA-/A-1+	AA/A-1+
UDC Finance Ltd.		
Issuer credit rating	AA-/Stable/A-1+	AA/Stable/A-1+
Esanda Finance Corporation Ltd.		

Issuer Credit Rating	AA-/Stable/A-1+	AA/Stable/A-1+
ANZ National Bank Ltd.		
Certificate of deposit		
Local currency	AA-/A-1+	
Not Rated Action		
	To	From
Australia and New Zealand Banking Group Ltd.		
Bank fundamental strength rating		
Local currency	NR	A
ANZ National Bank Ltd.		
Bank fundamental strength rating		
Local currency	NR	B+
Ratings Affirmed		
Australia and New Zealand Banking Group Ltd.		
Senior unsecured (59 issues)	cnAAA	
Short-term debt (1 issue)	A-1+	
Certificate of deposit (1 issue)	A-1+	
Commercial paper (1 issue)	A-1+	
ANZ National (Int'l) Ltd.		
Senior unsecured (6 issues)	cnAAA	
Commercial paper (2 issues)	A-1+	
ANZ National Bank Ltd.		
Certificate of deposit (1 issue)	A-1+	

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

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