Bank share buybacks – not a good look!

Much has been written about profitable companies “rorting” the job-keeper scheme by not repaying government-provided funds aimed at offsetting covid-19 losses and avoiding employee lay-offs. Nothing has been written about Australian banks getting the benefits of funding subsidies from the Reserve Bank’s Term Funding Facility (TFF), and now choosing to buy back their shares, rather than winding down their use of that facility (by repaying the amounts they have borrowed).

Clearly, profit motives drive the share buy-backs (debt is a cheaper source of funding than equity), but the ethics of buy-backs rather than winding down TFF use warrant attention.

Fundamental to understanding this issue is recognizing that shareholder equity capital and the TFF are alternative sources of funding for bank loans and investments. Buy-backs imply the banks have too much funding, and excess liquidity, given current loan demand and profitable investment opportunities.

A social, rather than private profit-oriented, perspective would lead to consideration of reducing the use of funds provided with a tax-payer subsidy (the TFF) rather than those provided by shareholders. I wonder if any bank boards considered this?

The TFF was introduced in March 2020 providing banks with access to three year funding at a fixed rate equal to the cash rate target of initially 25 basis points and then, from November 2020, 10 basis points. That was markedly lower than the market rates for bank borrowings at the time of introduction, and the 10 basis point rate is still in the order of at least 20-40 basis points below three year debt costs for the major banks.

The initial allowance available to each bank was 3 per cent of the bank’s current credit outstanding with additional allowances becoming available as its credit granted to (particularly small) business expanded. In aggregate, the initial allowance was $84 billion.

In September 2020 (when access to the initial allowance expired – and when banks had effectively used it all up) a further general allowance of $57 billion in aggregate was provided. In aggregate, including the additional allowances (reflecting increased credit granted), $213 billion was made available. When access to the scheme finished in July 2021, the banks had accessed $188 billion.

How much subsidy did the banks get – and was this passed on to borrowers via reduced loan pricing and more loans? A ball-park subsidy figure can be calculated assuming a 30 basis point TFF subsidy relative to bank bond funding costs per annum on the $188 billion dollars, giving an aggregate figure of around $560 million p.a. over three years. The four majors account for around 70 per cent of this.

If the banks passed all the subsidy onto business borrowers, then there is nothing inconsistent with reducing reliance on shareholder funding via buybacks and continued use of TFF funding. But if not, "robbing Peter [the taxpayer] to pay Paul [the shareholder]" has a bit of a smell about it!

Were the subsidies passed on as per the objective of the TFF policy? Who, other than bank management, knows? There is inadequate public data – although one would hope (perhaps forlornly, as per job-keeper) that some accountability would be required and that analysis is going on in the bowels of the RBA and Treasury.

The data that is available in RBA statistics could perhaps be interpreted as showing some small business borrower benefits – but the introduction of the government SME loan guarantee scheme could explain any interest rate benefits.

Business lending has been relatively stagnant, with RBA statistics indicating virtually no growth in outstanding loans for any of small, medium or large business categories since early 2020. But what it would have been in the absence of all the various government support measures is anyone's guess.

Housing credit has grown strongly, aided by the lack of constraints on the use of the TFF general allowances. And the banks have been swimming in a sea of liquidity, giving them scope to downsize their balance sheets.

Bank profitability has bounced back from early 2020 when it was hammered by large, precautionary, bad debt provisioning, now being reversed.

Bank balance sheets can stand the liquidity consequences and capital ratio effects of reducing their funding, either by share buy-backs or the winding down of their use of the subsidized TFF. But in the absence of evidence that banks have passed the TFF subsidies through to business borrowers, from a social perspective, doing buy-backs rather than terminating use of TFF funding is "not a good look".

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