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24 October 2008

Government Announces Details of Deposit and Wholesale Funding Guarantees

On 12 October 2008, the Rudd Government announced it will guarantee deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies for a period of three years. The Government also announced a guarantee on wholesale debt securities issued by these same institutions, on application, and for a fee.

I am today releasing further details of the guarantee arrangements following advice from the Council of Financial Regulators, which comprises the Reserve Bank Governor, the Secretary to the Treasury, and the Chairmen of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

Deposit Guarantee

As I indicated when introducing the deposit guarantee legislation in the House of Representatives last week, the Government has consulted on the interaction between the guarantee on eligible wholesale borrowing and the guarantee on deposits and whether measures are needed to clarify the intersection of these guarantees and facilitate their operation.

Today the Prime Minister and I received advice from the Council of Financial Regulators and, based on the Council's recommendations, the Government has decided that a threshold of \$1 million be implemented, over which a fee will be charged to receive the benefits of the deposit guarantee.

This fee will ensure the deposit and wholesale funding guarantees apply in a consistent manner for larger investments, for which deposits and securities are interchangeable. In particular, it will ensure that the deposit guarantee does not provide disincentives for market participants to operate in short-term money markets.

The fee will apply from 28 November 2008. Up until that date all deposits and wholesale funding eligible for the guarantee arrangements will be guaranteed without charge. After that date, deposits over \$1 million and wholesale funding will only be guaranteed if the relevant fee is paid.

Fee structure

The Government has accepted the Council of Financial Regulators' advice, to adopt a single rate fee for all maturities for eligible securities up to 60 months, with a different rate applying to eligible institutions based on their credit rating (see below).

Credit Rating	Debt Issues Up to 60 Months
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AA	70bp
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A	100bp
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BBB and Unrated	150bp
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This approach will provide an appropriate set of incentives for those ADIs who choose to use the guarantee and will minimise any unintended consequences for other debt markets.

The volatility and significant uncertainty that is evident in the current market environment means that it will be necessary for the wholesale guarantee fee arrangements to be reviewed on an ongoing basis and revised if necessary.

Other investments

The current global financial crisis is one of the most substantial shocks to the global economy seen in recent history. Australia's long-term economic fundamentals are strong. The Government believes that these strong fundamentals should underpin investment decisions.

The Rudd Government's action of 12 October guarantees 15 million deposit accounts, covering \$800 billion, and fund raising facilities of \$1.2 trillion used by financial institutions to finance small business investments and home loans.

In addition, the non-prudentially regulated investment sector also plays an important role in providing finance to the Australian economy.

The non-prudentially regulated investment sector typically includes mortgage trusts, non-listed property trusts and debentures. It provides investment capital to a range of projects (e.g. property development) and offers investment returns to retail investors. These vehicles are an important form of capital for the real economy.

Concerns have been expressed by industry about the impact of the current global financial crisis on this sector.

The Secretary to the Treasury and the Chairman of the Australian Securities and Investments Commission, in consultation with other financial regulators, are currently assessing all relevant actions that might be appropriate to foster the ongoing health and vitality of individual firms in this important sector of the economy.

This involves detailed consultation with the large number of firms delivering an array of complex investment products.

The Government has requested ASIC provide urgent advice in relation to retail investor hardship cases where redemptions may have been frozen, including using its modification powers under the Corporations Act to provide additional flexibility to fund managers and trustees.

Foreign bank branches

The Government recognises the role that foreign bank branches play in the ADI sector and that they are subject to APRA's prudential regulation framework applicable to foreign bank branches.

In light of these considerations, I am also announcing that foreign bank branches will be able to access the guarantee for short-term wholesale funding raised from Australian residents at the same premium that applies to other ADIs. Foreign bank branches will also be able to access the deposit guarantee in respect of domestic deposits held by Australian residents on the basis of the fee schedule, but with no fee-free threshold. This arrangement will be subject to strict limits and requirements to ensure the funding is used only for their Australian operations.

The past 12 months have seen conditions in global financial markets deteriorate significantly. Australians have witnessed the failure of a number of institutions overseas and we have not been immune from the impact. The Government has taken decisive action to shore up the Australian system.

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