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GOVERNMENT WITHDRAWS BANK FUNDING GUARANTEE AND STATE GUARANTEE

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Today the Rudd Government is announcing the withdrawal of its Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee) on 31 March 2010, acting on the advice of the Council of Financial Regulators (the Council).

Today's announcement does not affect the Financial Claims Scheme, which will continue giving over 16 million Australians certainty over their deposits of up to $1 million until the cap is reviewed in October 2011.

The Guarantee has been vital to the stability of our financial system when others were collapsing across the globe, leading to the first contraction in the global economy since World War II.

It gave our banks continued access to global capital markets on competitive terms, which has been critical in supporting the flow of credit through the Australian economy.

Australian banks and other lenders have so far paid around $1.1 billion for the use of the Guarantee and will pay around $5.5 billion over its full life.

Without the Guarantee, our banks would have lent less and interest rates for borrowers would have been higher, leading to lower growth and higher unemployment.

The Guarantee has also been vital in helping to support competition in the banking sector throughout the global financial crisis which hit smaller lenders particularly hard.

It has offered wholesale funding certainty to more than 150 Australian Authorised Deposit-taking Institutions, including regional banks, building societies and credit unions.

The Guarantee has allowed non-major Australian banks to raise over $32 billion in funding from international credit markets.

Together with the Government's direct investment of up to $16 billion in the RMBS market, this has helped smaller lenders to continue lending at competitive interest rates and competing with the big banks.

The Guarantee was first announced on 12 October 2008 in the face of severe dislocation on global credit markets which forced most G20 member countries to introduce some form of funding guarantee.

While our banks are highly-rated, well-capitalised and did not engage in the risky lending seen in some other countries – they still compete in global credit markets for funding against other borrowers all around the world.

The Australian Government acted quickly and decisively to ensure our banks stayed on a level playing field.

The Council – consisting of the heads of the Reserve Bank, Treasury, ASIC and APRA - has advised that bank funding conditions have improved such that the Guarantee is no longer needed, and that no Australian institution will need the Guarantee to fund themselves.

Importantly, our regulators explicitly advise that removing the Guarantee will not materially affect banking sector funding costs.

The Council also advises that it is appropriate we withdraw our Guarantee due to the greater strength of our financial system compared to key G20 countries which have already removed their guarantee or will do so shortly.

Existing guaranteed liabilities of authorised deposit-taking institutions (ADIs) will continue to be covered by the Guarantee to maturity for wholesale funding and term deposits, or to October 2015 for at call deposits. The final date for ADIs to apply for access to the Guarantee is 24 March 2010.

The Guarantee will cease to have effect from 5pm on 31 March 2010.

Today, the Government is also announcing the closure of the Guarantee of State and Territory Borrowing (State Guarantee) which has been critical to maintaining the capacity of state and territory governments to deliver on vital nation building investments.

The Government's announcement of the State Guarantee led to a sharp improvement in the pricing of state bonds relative to Commonwealth bonds and restored demand for state government bonds.

These benefits were experienced by all states, regardless of whether they opted to make explicit use of the guarantee.

The Government will close the State Guarantee to new issuance on 31 December 2010. The longer withdrawal period relative to the Guarantee of Large Deposits and Wholesale Funding is needed for states to establish liquidity in new unguaranteed bond lines.

Issuing bonds under existing lines is a critical source of funding for the states, so all states and territories will continue have access to the guarantee until the end of this year.

Existing guaranteed bonds will continue to be covered until either they mature or are bought back and extinguished by the issuer.

Today's announcement marks a further milestone in our recovery from the worst global recession in 75 years and continues the Rudd Government's record of responsible economic management.

CANBERRA
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