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Carl Schwartz

Nicholas Tan

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The Australian Government Guarantee Scheme: 2008–15

Carl Schwartz and Nicholas Tan*

The Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme or scheme) was introduced during the global financial crisis in response to similar measures taken in other countries, and to address extreme funding pressures on authorised deposit-taking institutions (ADIs). The scheme closed to new borrowings in early 2010 and the guarantee over the few remaining liabilities ended in late 2015. This article recaps the operation of the scheme and concludes that it successfully met its objective to promote financial stability and the flow of credit to the economy during a period of extreme global funding pressures. No claims against the government were made under the scheme and the fees paid for its use generated $4½ billion in revenue.

Background to the Guarantee Scheme

The Guarantee Scheme was introduced at a time of severe distress in global financial markets. The failure of Lehman Brothers in September 2008 sparked broad uncertainty about the stability of the global financial system and the ability of banks to access new funding. Australian ADIs' access to global long-term wholesale markets was curtailed and what funding occurred was at spreads that were significantly wider than normal. Deposit markets were also unsettled with some ADIs experiencing deposit outflows in October 2008.

Governments in a number of other countries introduced guarantee schemes to support funding of their financial systems, led by the Irish Government in September 2008. Other governments had little option but to follow as, in the uncertain environment, it was untenable for unguaranteed banks to compete for funding against their guaranteed peers. On 12 October 2008, the Australian Government announced increased depositor protection and guarantee arrangements for ADI funding. Details of the scheme were announced on 24 October 2008 following advice from the Council of Financial Regulators (CFR), and the scheme became operational on 28 November 2008, under the administration of the Reserve Bank. Depositor protection arrangements were strengthened through the introduction of the Financial Claims Scheme, to initially cover deposits of $1 million or below.

* The authors are from Financial Stability Department.

By guaranteeing certain liabilities, the Australian Government looked to bolster confidence in ADIs and ensure that an otherwise sound ADI would not experience financial distress due to a shortage of funding. The aim was to promote the stability of the Australian financial system and an ongoing supply of credit to the economy, while ensuring that Australian institutions were not placed at a disadvantage to their international peers that could access similar government guarantees.

Design Features

The Guarantee Scheme enabled eligible ADIs to access a government guarantee for large deposits and wholesale liabilities. In exchange for the guarantee, which bestowed the government's AAA rating on this debt, ADIs paid a monthly fee based on their credit rating and the value of the debt/deposits guaranteed.

The scheme shared many features with wholesale debt guarantee arrangements announced in other countries although, on balance, it was more flexible and generally at the more supportive end of the international range (Schwartz 2010). This was by design: the emphasis was on supporting financial stability by seeking to deliver arrangements that decisively addressed potential investor concerns without the need for subsequent further interventions. Specifically:

- **Size of the scheme:** the government did not limit the total value of liabilities covered, in contrast to most other schemes. Countries that imposed limits tended to apportion them based on the outstanding debts of an institution or some proportion of their size (BIS 2009).
- **Term of the guaranteed debt:** the Australian scheme covered issuance at different maturities up to a maximum of five years (less for foreign bank branches).[1] ADIs could issue debt up to this maximum at any point while the scheme remained open to new issuance. In comparison, many other schemes nominated a maximum maturity date – often three years – beyond which debt would not be guaranteed. It was later extended in some cases.
- **Closure date:** no closure date was announced when the scheme was introduced, rather it was declared open 'until conditions normalise'. Most other governments set a closure date when announcing their schemes, with many subsequently extending these dates.
- **Fees:** for highly rated borrowers (AA- and above), the fee charged under the Australian scheme was ultimately relatively low compared with those in other countries.[2] The difference in fees between highly rated and lower-rated borrowers in Australia was, in contrast, high by international comparison (Table 1).[3] Monthly fees were charged on the balance of outstanding guaranteed liabilities, which was in contrast to many other countries where fees were charged up front for the life of the security/scheme and were non-refundable.

Table 1: Government Long-term Wholesale Debt Guarantee Pricing[(a)]
Basis points per annum

Country	Minimum fee AA- rated or better	Maximum fee	Range
Australia	70	150	80
Netherlands	73	113	40
Sweden	74	95	21
Spain	87	105	18
New Zealand[(b)]	90	200	110
Denmark	95	95	0
United Kingdom[(c)]	99	125	26
South Korea	100	100	0
Canada	110	135	25
United States	125	125	0

(a) Final fee schedule
(b) NZ$ fee (subtract 20 basis points for foreign currency fee)
(c) RBA estimates based on credit default swap premiums
Sources: BIS; Bloomberg; RBA; Treasury departments, central banks, debt management offices and guarantee administrators

1 Foreign branches were treated differently because, unlike foreign bank subsidiaries, they are not separate legal entities with their own regulatory capital held in Australia. Initially they were given a fixed maturity limit of 31 December 2009, subsequently changed to a rolling 15-month maturity limit.

2 The level of fees was comparable to the initial fee under the US guarantee arrangements, but the US authorities subsequently raised the fee.

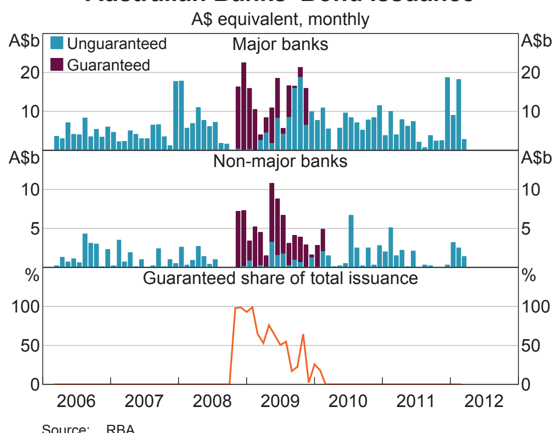
3 See Schwartz (2010).

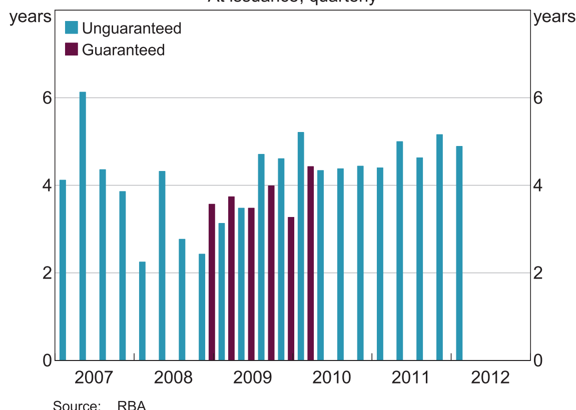
Use of the Guarantee Scheme

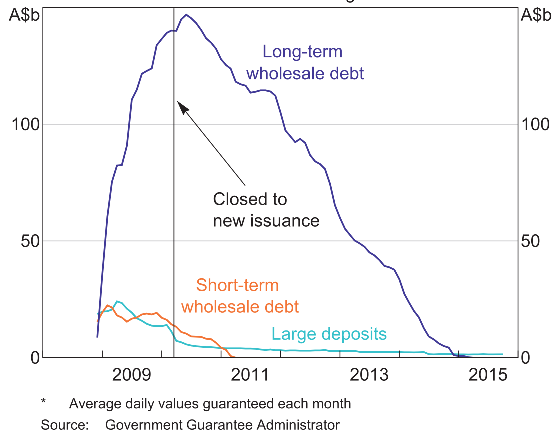
Late 2008 to early 2010: Scheme open to new liabilities

The Guarantee Scheme had immediate impact. After a short period of virtually no long-term debt issuance, ADIs issued large volumes of guaranteed debt as soon as the scheme became operational in late 2008. In the three months before its introduction, ADIs issued bonds worth $2 billion, while in the first three months of the scheme they issued $73 billion of bonds ($70 billion of which was guaranteed) (Graph 1). This initial period, when risk aversion among investors was highest, marked the peak use of the scheme. Thereafter, the guaranteed bonds' share of total bond issuance fell from 100 per cent in late 2008 to around 30 per cent in late 2009, with the fee structure providing an incentive for ADIs to return to unguaranteed forms of funding as markets normalised. Initially, ADIs used the scheme to issue at slightly longer maturities than for unguaranteed liabilities (Graph 2).

At its largest, the scheme covered $170 billion of liabilities, equivalent to 7½ per cent of total ADI liabilities. The scheme was mainly used for new long-term wholesale liabilities (Graph 3) as ADIs sought to lengthen the maturity structure of their liabilities. The guarantee of large deposits and short-term wholesale debt was less prevalent, though the availability of the guarantee for the range of instruments offered funding flexibility for ADIs with different funding compositions. For example, smaller institutions generally have a higher share of deposit funding. Indeed, non-major ADIs accounted for a relatively large share of guaranteed large deposits in the early months of the scheme. Non-major ADIs, including foreign-owned subsidiaries and branches, accounted for a large share of short-term debt issuance over the life of the scheme, partly reflecting the fact that foreign-owned bank branches were not permitted to issue guaranteed debt with a tenor greater than 15 months.







The main users of the scheme in absolute terms were the four major Australian banks, though issuance as a share of liabilities was higher among non-major Australian banks (Table 2). This was driven by the behaviour of some of the larger non-major Australian banks, where guaranteed long-term bond issuance accounted for over 10 per cent of their liabilities. Prior to the crisis, non-major banks had issued comparatively small amounts of bonds, making greater use of residential mortgage-backed securities markets. However, with the adverse events of the crisis and consequent investor aversion to securitisation markets, these banks issued large amounts of guaranteed bonds in late 2008 and into 2009.

The government closed the scheme to new issuance from the end of March 2010, following advice from the CFR that funding conditions had 'normalised'. The CFR had noted that the scheme was no longer primarily being used to address problems of market access and that similar schemes in many other countries had closed or were soon to close. By the time the scheme closed to new issuance, Australian banks had significantly shifted their funding practices to structures considered more stable, boosting deposit and long-term funding while reducing use of short-term wholesale funding.[4] Such moves were consistent with international efforts to strengthen financial system resilience by regulators and institutions in the wake of the global financial crisis.[5]

Early 2010 to late 2015: Movements in existing guaranteed liabilities

Following the closure of the Guarantee Scheme to new issuance, the stock of guaranteed bonds began to fall around mid 2010 as previously issued guaranteed bonds matured.[6] By the start of 2011, changes in the stock of total guaranteed debt were almost wholly determined by changes in guaranteed long-term debt, as the amounts of short-term debt and large deposits guaranteed were much smaller and had already fallen from their peaks. In addition to the downward effect of maturities on the outstanding stock, institutions began buying back their government-guaranteed debt as market conditions improved (Graph 4).[7] Around the start of 2011, the all-in cost of guaranteed debt – including the government fee – had become more expensive than issuing new unguaranteed debt (Graph 5). As the maturity profile of the guaranteed debt shortened, it became increasingly attractive for the major ADIs to buy back guaranteed bonds with between 12 and 18 months remaining to maturity.

Major ADIs accounted for just over half of total buybacks in absolute terms, but non-major ADIs bought back considerably more guaranteed debt as a share of guaranteed debt issued. Non-major ADIs bought back around $25 billion of guaranteed debt, or just over 50 per cent of their guaranteed issuance, while major banks bought back $33 billion, equal to about 33 per cent of their issuance. This ability to buy back guaranteed debt allowed for a faster return to standalone market-based funding and reduction in government contingent liabilities than would otherwise have been the case.

The bulk of buyback activity for guaranteed debt occurred between late 2012 and mid 2013. After that, changes in the stock of guaranteed debt were largely driven by the maturity of long-term wholesale debt. The final guaranteed bond matured in early 2015, though the guarantee extended until 24 October 2015 over the residual value of at-call large deposits – around $1.4 billion. The continuation of the guarantee seven months beyond the length at which the final guaranteed bond matured reflected a decision made in its initial design to allow time in the event that investors needed to make a claim after maturity.[8]

4 For further discussion of this change, see Deans and Stewart (2012).

5 For further discussion of improvements to ADIs' liquidity management, see RBA (2015).

6 The value of the stock of outstanding guaranteed bonds also fell with the appreciation of the Australian dollar, given that many bonds had been issued in foreign currencies (mostly US dollars).

7 Though the first buyback of guaranteed debt occurred early in mid 2009, buyback activity was not prominent until 2011.

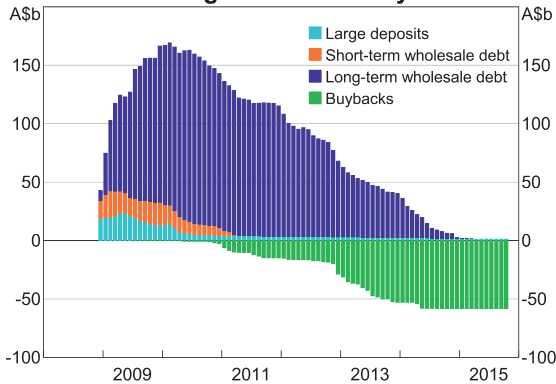
8 For further discussion, see RBA (2013).

Table 2: Bank-issued Government-Guaranteed Debt
March 2010

	Outstanding long-term bond issuance	Share of total liabilities	Memo item: Guaranteed wholesale liabilities as a share of wholesale liabilities
	A$ billion	Per cent	Per cent
Major banks	94.9	4.1	14.2
Non-major banks	45.2	8.3	18.1
Australian-owned	32.1	11.7	42.2
Foreign-owned	13.1	4.8	10.3
Total	140.1	4.9	15.5

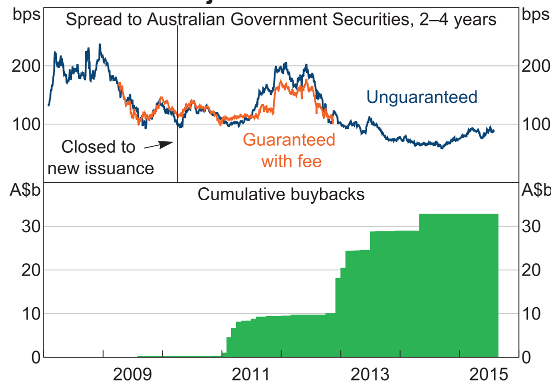
Sources: Government Guarantee Administrator; RBA

Graph 4
Guarantee Scheme
Outstanding Stocks and Buybacks*



* Average daily values guaranteed each month
Source: Government Guarantee Administrator

Graph 5
Major Bank Bonds



Sources: Government Guarantee Administrator; RBA; UBS AG Australia Branch

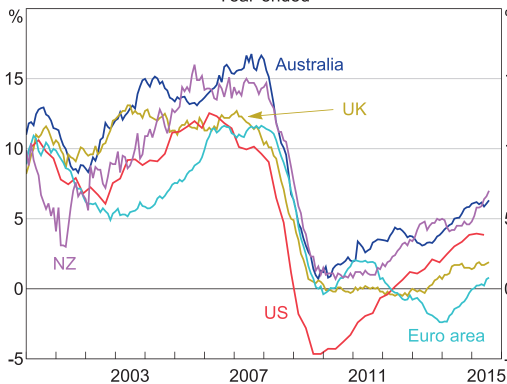
Assessing the Guarantee Scheme

There are strong grounds to conclude that the Guarantee Scheme was successful. It achieved its objective of helping to stabilise the financial system and promote the flow of credit to the economy, while ensuring that Australian institutions were not placed at a disadvantage to their international peers that could access similar government guarantees. While there were many factors supporting the resilience of the Australian economy and financial system during this period relative to those in other countries, the heavy use of the scheme shows that it played an important role in bolstering funding for the financial sector, thereby supporting credit provision to the economy (Graph 6).[9] In doing so the Guarantee Scheme incurred no losses, suggesting that the settings were appropriate for the circumstances. For the support provided to ADIs, the scheme earned the government fees of $4½ billion.

The scheme's intervention in markets was relatively contained to the period where it was required. It was introduced soon after international conditions and the actions of international authorities necessitated it, and it was closed to new issuance when other international schemes had started to close and market conditions were judged to have

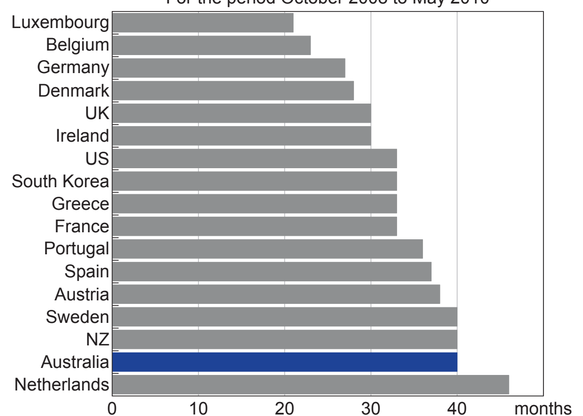
9 See Davis (2011) for a study of Australia's financial system during the crisis.

Graph 6
Private Sector Credit Growth
Year-ended



Sources: Bank of England; European Central Bank; RBA; Thomson Reuters

Graph 7
Average Maturity at Issuance
For the period October 2008 to May 2010



Source: Levy and Schich (2010)

normalised. The judgement-based closure of the scheme, as opposed to using a pre-announced closure date (as in a number of other countries), avoided potential market uncertainty over whether arrangements would be extended in the lead-up to the pre-announced closure dates; in contrast, there were multiple extensions of arrangements in a number of other countries.

The pricing structure and fee payment arrangements also supported the 'natural exit' of the guarantee arrangements when market conditions normalised. In addition to the pricing incentive on new issuance, the pricing structure and fee payment arrangements encouraged and facilitated ADIs buying back guaranteed debt, thereby hastening the reduction in the stock of government-guaranteed debt and the government's contingent liability. The buyback feature of the scheme appears unique among countries with a guarantee. The monthly fee payment, as opposed to an upfront fee, also had the benefit of not draining additional funds from ADIs at a time when pressures on their liquidity were most acute.

A number of features of the scheme compared favourably with other schemes internationally in being relatively supportive of financial stability at the margin. For example, the relatively long maximum maturities allowed ADIs more flexibility to lengthen maturities (Graph 7) and avoid bunching of refinancing risk. The lower fee structure overall was relatively supportive of ADI funding and therefore credit provision.

In doing so, the scheme generated a level of contingent liabilities for the government which, on a number of metrics, was large by the standards of international schemes (Table 3). It is important to note, though, that the size of contingent guarantees over banking system bonds is only a partial indication of governments' exposure to banking systems. Governments in other countries incurred liabilities from various other channels, including direct liabilities from asset purchases and capital injections that sometimes generated losses.

The size of the scheme relative to those in other countries partly reflects some important structural and cyclical differences. The funding structure of Australian banks has a higher weight on wholesale funds than many other banking systems. When the scheme was enacted there was only modest government support for alternative funding sources such as residential mortgage-backed securities markets and covered bonds were not available. Also, credit growth in Australia remained relatively resilient compared with that in other countries. Australia is reported to be one of only a handful of countries where banking institutions recorded net issuance of bonds between October 2008 and May 2010: over the life of the scheme, ADIs issued around 50 per cent more by value of guaranteed bonds than expired from unguaranteed bonds.[10]

10 As reported in Levy and Schich (2010). The other countries were Austria and Denmark.

Table 3: Guaranteed Bond Issuance
October 2008 to May 2010

	Total issuance US$ billion	Per cent of 2010 country banking system assets	Per cent of 2010 country public sector revenue
Australia	145	6.0	54
Denmark	43	5.7	34
Ireland	81	5.2	120
New Zealand	8	2.8	16
Sweden	24	2.5	16
United States	328	2.5	14
Germany	243	2.2	26
Austria	26	2.0	19
United Kingdom	195	1.8	24
France	169	1.8	15
Netherlands	62	1.7	19
Greece	11	1.7	10
Spain	53	1.3	15
Portugal	6	0.8	7
Belgium	5	0.4	3
Luxembourg	1	0.1	4
South Korea	1	0.1	1

Sources: Helgi Library; Levy and Schich (2010); RBA; World Bank

Despite the large contingent liability, no claims were made against the scheme. Consideration was given to risk in the design of the scheme and monitoring of its use. In a global systemic crisis it was judged preferable to err on the side of supporting the financial system with simple, easy to understand arrangements, than to impose greater control over exposures through features such as limits or institution-specific pricing. This also reflected the assessment that the Australian banking system entered the crisis in sound condition.

There were also a number of safeguards in the scheme and its operation. The rules specified that institutions seeking involvement required Australian Prudential Regulation Authority approval.[11] Foreign branches, which are subject to less Australian supervisory oversight, had a number of restrictions, such as shorter maturities; total guaranteed liabilities could not exceed 110 per cent of the average daily value of short-term liabilities and deposits in the 30 days prior to the announcement of the scheme; and their guaranteed liabilities could not be used to directly support the foreign branch outside Australia or the obligations of its parent or any related entity. There was close monitoring of exposures and regular reports to the CFR on aspects such as individual bank exposures and foreign branch activities.

Conclusion

The Guarantee Scheme was a significant government intervention taken in late 2008 in response to similar actions by authorities abroad during the global financial crisis. It was closed to new liabilities from the March quarter in 2010, and

11 See Australian Government (2012) for full scheme rules.

the amount guaranteed progressively wound down until the guarantee over the low level of remaining liabilities expired in late 2015. By ensuring continued access to funding markets, the scheme successfully supported the Australian financial system and economy through the period of extreme pressure on banking systems globally. Design features of the scheme helped to contain its use to the period when it was needed most: as market conditions normalised, the fee structure discouraged issuance of guaranteed debt and encouraged ADIs to buy back guaranteed debt. The scheme incurred no losses, suggesting that the settings were appropriate for the circumstances, and earned fees of $4½ billion from ADIs for the support provided. ✠

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