

Prime Minister of Australia

Media Release

Global Financial Crisis

12 October 2008

Global financial markets are experiencing some of the most challenging conditions ever witnessed.

In recent days, as global financial conditions have deteriorated markedly, governments around the world have taken unprecedented steps to guarantee the liabilities of their financial systems.

The Australian financial system is demonstrating its resilience to the international financial market turbulence. Australia's banking institutions remain sound, well-capitalised and profitable with high asset quality.

The Australian financial system is however being affected by global events. Recent developments in the international wholesale funding markets have created acute funding pressures that now pose potential risks to the total supply of finance to the Australian economy.

This has the potential to slow further domestic economic activity.

The G-7 met on 10 October and agreed that the current situation calls for urgent and exceptional action to stabilise financial markets and restore the flow of credit, to support global economic growth.

Guarantee on deposits

In response to these developments the Australian Government will guarantee all deposits of Australian banks, building societies and credit unions and Australian subsidiaries of foreign-owned banks.

This guarantee will operate for a period of three years. This is similar to action that has been taken in a number of countries.

The guarantee will be legislated as part of the Financial Claims Scheme (FCS). For the first three years of its operation, there will be no cap.

The guarantee will operate from the date of this announcement. From today there will be no limit on deposits covered by the FCS. In three years time, the Government will review this position.

New measures to enhance the powers of the Australian Prudential Regulation Authority (APRA) will be legislated.

Guarantee of term funding for institutions

The Australian Government will also guarantee wholesale term funding of Australian incorporated banks and other authorised deposit-taking institutions (ADIs).

The Government will offer the guarantee in return for a fee in respect of eligible non-deposit debt obligations of Australian ADIs and foreign subsidiary banks operating in Australia.

It will enable Australian institutions to raise funds overseas in the current tight conditions and will restore confidence in credit markets. The facility will be withdrawn once market conditions have normalised. Details will be finalised in the next few days.

Purchases of RMBS from non-ADI lenders

Further to the Treasurer's announcement in September, the Government has decided to direct the Australian Office of Financial Management (AOFM) to purchase an additional \$4 billion in Residential Mortgage Backed Securities (RMBS).

The Government has been monitoring the market closely and has determined that this additional \$4 billion in funding is required for the purchase of RMBS from non-ADI lenders (those being lenders who are not banks, building societies or credit unions) by the AOFM.

This will benefit Australia's mortgage market by levelling the playing field for non-ADI institutions and ensuring that this sector of the lending market has access to funding for their operations.

My officials have done considerable work on the design of these arrangements and, in developing these measures I have received advice from the Governor of the Reserve Bank of Australia, the Chairman of the Australian Prudential Regulation Authority and the Secretary to the Treasury.

Collectively, these measures will reassure Australian depositors that their deposits are safe and that they can have full confidence in the Australian financial system.

In addition, these measures will assist Australia's financial institutions weather the global financial turbulence.

Background

Interim Government Guarantee of Deposits and Funding of Authorised Deposit Taking Institutions.

The Australian banking system continues to demonstrate its resilience to the international financial market turbulence. Australian authorised deposit-taking institutions (ADIs) continue to be assessed as sound and the sector remains well capitalised and very profitable with high asset quality.

The Australian banking system is, however, affected by the global events. In recent days, as global financial conditions have deteriorated markedly, governments around the world have taken unprecedented steps to guarantee the liabilities of their financial systems.

European governments (Ireland, Germany, Denmark and Iceland) have moved to insure 100 per cent of eligible deposits. Other jurisdictions have significantly increased their deposit insurance caps. For example the Federal Deposit Insurance Corporation in the United States has lifted its cap from \$100,000 to \$250,000 per depositor until 31 December 2009; the UK has raised the value of deposits it insures to £50,000 from £35,000; the EU has increased its minimum deposit insurance limit to €50,000 from €20,000.

Governments are also providing unprecedented support to their financial institutions in order for them to recapitalise and gain access to wholesale borrowing. For example, the UK Government has made available to eligible institutions a Government guarantee on short- and medium term debt issuance. This will assist institutions operating in the UK to refinance their wholesale funding obligations as they fall due.

Having carefully reviewed international developments, the Australian Government, acting on the advice of the regulators, has decided that it must act to provide the same guarantees for our banks and other financial institutions. If we do not do so, Australian financial institutions could, over time, find it more difficult to borrow in international financial markets. They would become uncompetitive in attracting funds in markets that have become increasingly tight and risk-averse as this global financial crisis has deepened.

What action is the Government taking?

Guarantee on deposits

As part of the Government's Financial Claims Scheme, the Government is guaranteeing all the deposits held in Australian-owned banks, Australian subsidiaries of foreign-owned banks, building societies and credit unions.

The guarantee will apply immediately, and remain in place for three years. This means from today, there will be no limit on the deposits covered by the Financial Claims Scheme. At the end of the three-year period, the Government will review the cap on the guarantee.

Deposits covered

The guarantee applies, from today, to all deposits held in Australian-owned banks, Australian subsidiaries of foreign-owned banks, building societies and credit unions. These institutions are authorised to accept deposits by APRA and are subject to prudential regulation to protect the safety of these deposits.

The guarantee applies to all types of deposits, regardless of the type of account through which the deposit is made. For example, it includes savings accounts, passbook accounts, cheque accounts, pensioner deeming accounts, term deposits, mortgage offset-accounts, farm management accounts, first home savers accounts and retirement savings accounts. Both retail and wholesale deposits are covered by the guarantee.

The guarantee applies to deposits held by all types of legal entities in Australia, including individuals (including joint accounts), partnerships, businesses, trusts and government entities.

The guarantee applies to deposits denominated in any currency.

The guarantee does not apply to deposits held in branches of foreign banks in Australia. These deposits are not subject to the depositor protection provisions of the Banking Act 1959.

Guarantee of term funding for institutions

The Government is making available to Australian-owned banks, Australian subsidiaries of foreign owned banks, building societies and credit unions a guarantee on eligible wholesale borrowing.

The Government will offer the guarantee in return for a fee in respect of eligible non-deposit debt obligations of eligible institutions. It will enable Australian institutions to raise funds overseas in the current tight conditions and will restore confidence in credit markets. The facility will be withdrawn when market conditions normalise.

To ensure that taxpayers are not disadvantaged by this guarantee, the Australian Government will charge financial institutions for providing the guarantee. This charge will be similar to an insurance premium. Effectively, the Australian Government is insuring the eligible liabilities of Australian financial institutions.

Funding covered

The guarantee on wholesale borrowing will be made available to Australian-owned banks, Australian subsidiaries of foreign-owned banks, building societies, and credit unions. It will be available, on application, for new and existing term debt issuance out to 5 years (60 months). The guarantee will be available for eligible debt instruments issued in all major currencies.

The guarantee will not be available to foreign banks, including those with branches in Australia, or entities that are not APRA-authorised deposit-taking institutions. These latter entities are not subject to Australia's prudential regulation regime.

Lenders that are not APRA-regulated will have access to the Government's complementary initiative to invest an additional \$4 billion in residential mortgage-backed securities (see below).

Purchases of RMBS from non-ADI lenders

On 26 September, the Treasurer announced the direction to the Australian Office of Financial Management (AOFM) to purchase residential mortgage-backed securities (RMBS) from a wide range of Australian lenders in initial tranches totalling \$4 billion.

The Government has been monitoring the market closely and has determined that an additional \$4 billion in funding is required for the purchase of RMBS from Australian non-ADI lenders (those being lenders who are not banks, building societies or credit unions) by the AOFM. This will benefit Australia's mortgage market and ensure that this sector of the lending market has access to funding for its operations.

This initiative will also provide a level playing field for the non-ADI lenders who will not have the benefit of the guarantee of the term funding facility.