Inquiry into the Bank Funding Guarantees

Submission to the
Senate Economics Committee

July 2009

The Government's Large Deposits and Wholesale Funding Guarantees were announced in October 2008. The announcement followed an agreement by G7 countries to do whatever was necessary to prevent the collapse of the financial system. The collapse of Lehman Brothers had occurred in September 2008 and it appeared the financial situation would deteriorate rapidly.

Actions taken by governments around the world included instituting guarantees on deposits. For example, European governments, including Ireland, Germany, Denmark and Iceland, moved to insure 100% of eligible deposits. Other governments, including the US and the UK, increased their deposit insurance caps. Governments also provided support for financial institutions to gain access to wholesale borrowing, including guarantees on debt issuance.

On 12 October 2008, the Australian Government announced that it would provide similar guarantees. In the Prime Minister's announcement, he acknowledged that the Australian banking system is affected by global events and, if they did not follow international developments, Australian financial institutions could find it more difficult to borrow in international financial markets. The Australian Government's decision to put in place deposit and wholesale funding guarantees was a rational response to the environment. ANZ supported the Government's provision of the schemes.

Fortunately, no Australian financial institution has needed financial support from the guarantees. The Government has not bailed out any Australian financial institution as has occurred in many other developed countries. As at June 2009, the guarantee scheme had generated $457.8 million in revenue for the Government.[1]

ANZ offers the guarantee to its customers for large deposits and has used the wholesale funding guarantee. There has been limited customer or investor appetite for the large deposit or short-term wholesale debt components. As at 30 June 2009, $2.2 billion of large deposits held with ANZ were guaranteed by the Government. ANZ also had $15.7 billion on financial markets outstanding with the backing of the wholesale funding guarantee ($15.6 billion in long-term funding and $0.1 billion in short-term funding). To access these guarantees, ANZ has paid the Government $55.7 million.

While the outlook has improved somewhat, for the last year global financial markets have been extremely uncertain and volatile. Between the collapse of Lehman Brothers and the start of the Government wholesale funding guarantee, wholesale funding markets were effectively closed to Australian financial institutions and most institutions globally. During this time ANZ did not issue any material volume of new term funding (>1 year) on global markets.

The wholesale funding guarantee has facilitated access to global wholesale funding markets for Australian financial institutions. Nevertheless, the price of wholesale funding remains elevated in comparison to pre-crisis prices. The following charts show

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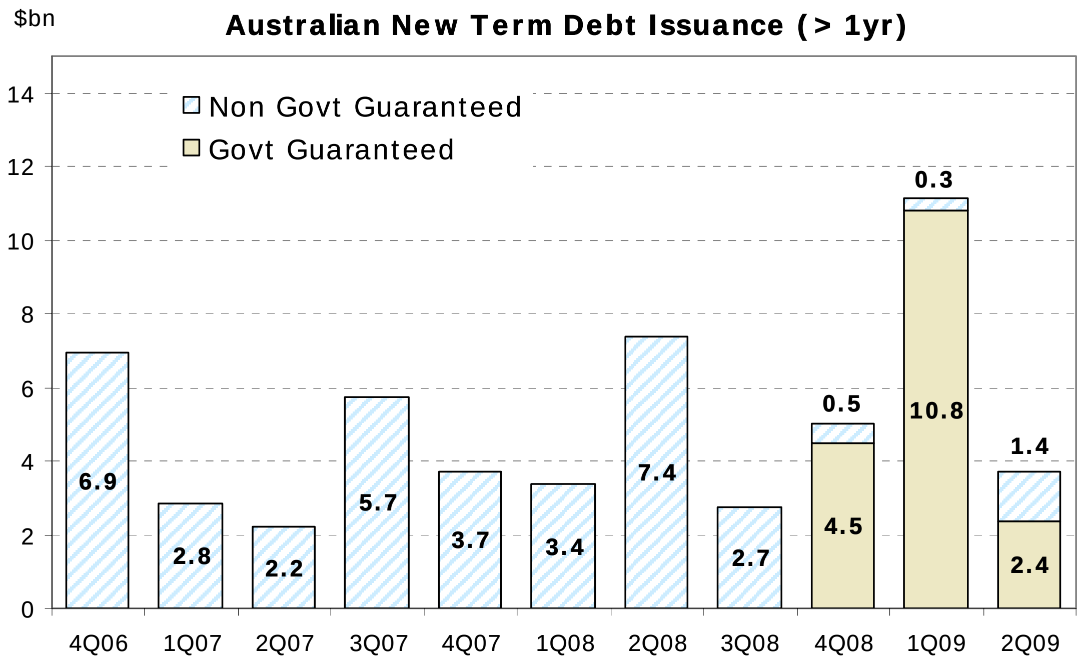
[1] http://www.guaranteescheme.gov.au/liabilities/summary-info.html

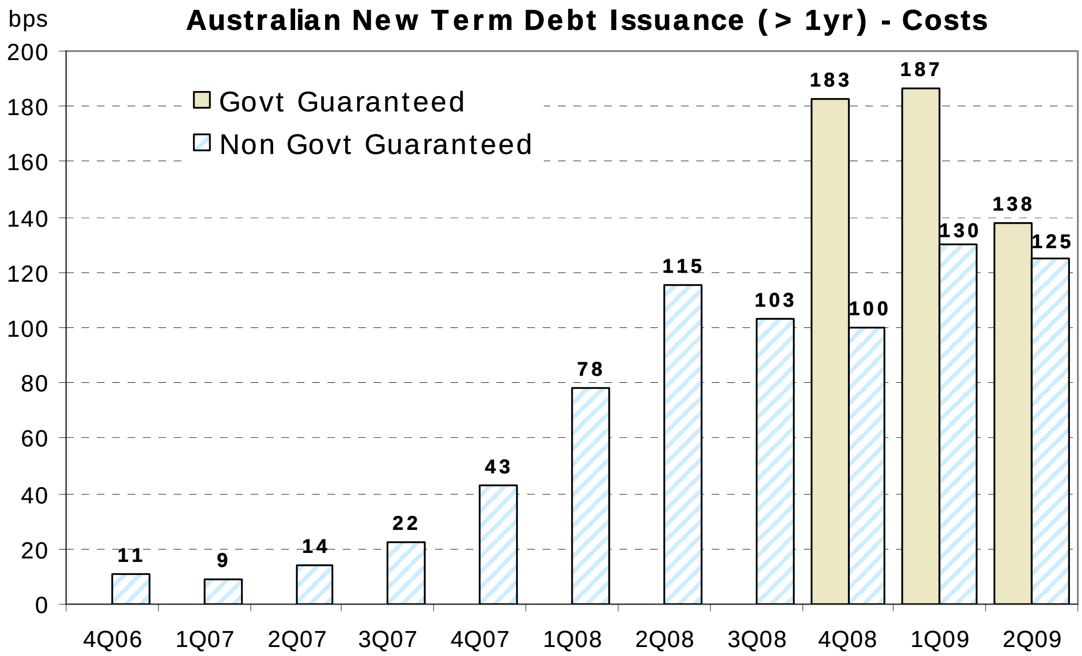
the recent volumes and costs of new term debt issued by ANZ with an original tenor of greater than one year.

The chart below shows the almost complete reliance on the Government wholesale funding guarantee in fourth quarter 2008 and first quarter 2009 and that in the second quarter 2009 some non-guaranteed issues have been achievable.



The chart below shows costs relative to the reference rate (BBSW), including issuance spread, Government Guarantee fee, hedging/currency conversion costs and other fees. The cost of debt issued using the Government guarantee increased sharply in 4Q08 and 1Q09 and while falling somewhat in 2Q09 remained much higher than had been the case in the first half of 2008. The non-Government guaranteed issues in 4Q08, 1Q09 and 2Q09 are based on the small volumes shown above, raised mainly in domestic markets. While domestic markets are cheaper, they are too small to enable Australian companies to meet their funding requirements.

The cost shown for non-guaranteed debt does not represent the cost of borrowing in global financial markets in those periods which was substantially higher. The gap has closed somewhat in second quarter 2009 which, as noted above, has allowed us to raise some non-guaranteed debt on global markets.



In offshore markets, the cost of issuing debt without the backing of the guarantee remains higher than guaranteed funding. For example five-year non-guaranteed funding in US dollars costs approximately 75bps more than either five-year guaranteed funding in US dollars (inclusive of the guarantee fee) or five-year non-guaranteed funding in Australian dollars.

The guarantees have been an important means of instilling confidence in both depositors and investors. The Australian banking system is, however, strong. Four of the 11 “AA” rated banks in the world are in Australia – ANZ is one of them. Furthermore, conditions in wholesale funding markets are improving. Provided this situation does not deteriorate, the guarantees should be removed in an orderly way, coordinated with similar actions in the major European and North American economies.

At the same time, ANZ believes that the deposits guarantee should be replaced by a Financial Claims Scheme with a lower cap as originally proposed by the Government. ANZ would be concerned that simply removing the wholesale guarantee without amending the deposit guarantee (as suggested above) would give rise to further arbitrages between the two markets.

ANZ would be pleased to provide any further information about this submission as required, and can be contacted as follows:

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