

4 July 2009

The Secretary  
Senate Economics Legislation Committee  
PO Box 6100  
Parliament House  
Canberra ACT 2600

Dear Sir / Madam,

**INVESTEC BANK (AUSTRALIA) LIMITED - SUBMISSION TO SENATE ECONOMICS REFERENCES COMMITTEE'S INQUIRY INTO BANK FUNDING GUARANTEES**

Investec Bank (Australia) Limited ("Investec") is an Australian Bank (or Approved Deposit-taking Institution ("ADI")) owned by a foreign parent and is referred to as a "Foreign Subsidiary Bank" by the Australian Prudential Regulatory Authority ("APRA").

Investec is one of a number of smaller / specialist ADIs that provide a vital role in terms of delivering choice, competition and specialist services to the customers in the Australian market. With this perspective Investec provides the following submission to the Committee:

**Key Points and Suggested Actions**

**1. Non-rational market pricing and the impact of the Guarantee fee.**

Despite the support provided by the Government's Wholesale Bank Funding Guarantee Scheme ("the Scheme") "rational pricing" has not actually developed in the funding market, rather all ADIs are paying funding margins consistent with investors "looking through" the Government Guarantee (or treating it as a necessary but not sufficient basis for investing) and with lower rated institutions paying a higher margin again.

Normally this would suggest that the Guarantee fee should be lowered to offset the impact of non-rational pricing, and its negative impact of the cost and availability of finance, however in order to both preserve budgeted Government revenues and to create a positive incentive for ADIs to avoid the use of the Guarantee (where feasible), Investec believes the Guarantee fee should remain at the level currently set for "AA" rated institutions.

Investec suggests the Government should maintain the Guarantee fee charged at the level currently set for “AA” rated ADIs as a positive incentive for ADIs to avoid the use of the Guarantee (where feasible).

2. Cost impacts are “choking off” otherwise viable real economic activity, with the cost burden disproportionately born by smaller/specialist ADIs making their operations potentially unsustainable.

The combination of “non-rational” market pricing and the impacts of the Guarantee fee create a cost of funds that make many financing proposals unviable. This impact is exacerbated for smaller/specialist ADI’s and may threaten the sustainability of their operations.

Whilst market pricing has improved somewhat over the last few months, the following table highlights the scale of these cost impacts and their particular effect on smaller/specialist ADIs :

| Cost of Wholesale Term Debt Issuance |                            | "AA Rated"   | "A Rated"    | "BBB Rated"  |
|--------------------------------------|----------------------------|--------------|--------------|--------------|
| <b>Pre-Global Financial Crisis</b>   | <b>Total Cost of Funds</b> | <b>0.10%</b> | <b>0.20%</b> | <b>0.35%</b> |
| <b>January 2009</b>                  | Debt Margin (approx.)      | 0.80%        | 1.05%        | 1.30%        |
|                                      | <u>Guarantee Fee</u>       | <u>0.70%</u> | <u>1.00%</u> | <u>1.50%</u> |
|                                      | <b>Total Cost of Funds</b> | <b>1.50%</b> | <b>2.05%</b> | <b>2.80%</b> |
| <b>June 2009</b>                     | Debt Margin (approx.)      | 0.35%        | 0.60%        | 0.80%        |
|                                      | <u>Guarantee Fee</u>       | <u>0.70%</u> | <u>1.00%</u> | <u>1.50%</u> |
|                                      | <b>Total Cost of Funds</b> | <b>1.05%</b> | <b>1.60%</b> | <b>2.30%</b> |
| <b>"Rational" Pricing</b>            | Debt Margin                | 0.00%        | 0.00%        | 0.00%        |
|                                      | <u>Guarantee Fee</u>       | <u>0.70%</u> | <u>1.00%</u> | <u>1.50%</u> |
|                                      | <b>Total Cost of Funds</b> | <b>0.70%</b> | <b>1.00%</b> | <b>1.50%</b> |
| <b>"Suggested" Pricing</b>           | Debt Margin                | 0.35%        | 0.60%        | 0.80%        |
|                                      | <u>Guarantee Fee</u>       | <u>0.70%</u> | <u>0.70%</u> | <u>0.70%</u> |
|                                      | <b>Total Cost of Funds</b> | <b>1.05%</b> | <b>1.30%</b> | <b>1.50%</b> |

As detailed above under “Suggested Pricing”, Investec suggests the Government consider flattening the fee structure across the credit rating grades to eliminate the “double penalty” impact currently being borne by lower rated ADIs and creating an uneven competitive landscape to the disadvantage of smaller ADIs.

- 3. Government Policy to date has been largely directed to address financial system confidence which primarily supports “the large end of town”, however improving economic activity is fundamentally dependent on directly supporting the activity of “employment intensive” small to medium business enterprises.**

Investec believes the Government needs to balance the access, perspective and privileged position that the four Major Banks (the “4 Majors”) have in potentially influencing those Government policies that are aimed at responding to the Global Financial Crisis, with an active need to support and promote the position of smaller/specialist ADIs and the competitive dynamic they bring to the Australian financial sector.

While it is understandable that large scale financial transactions have a high profile impact on sentiment and market confidence, it is smaller scale transactions that more immediately affect a wide range of individuals’ real disposable income (and thereby economic activity), as generally small to medium enterprises are more “employment intensive” being larger employers on a “dollar for dollar turnover” basis than the “large end of town”.

**Investec suggests the Government consider increasing the funding provision to AOFM and widening the AOFM’s investment criteria to allow it to actively support the securitised finance of:**

- i. medical dental, accounting and allied professional lending and leasing finance;**
  - ii. other forms of finance specifically directed at supporting “real economy employment intensive” activity particularly in the small to medium business sectors.**
- 4. Certainty as to the mechanisms and timing of any changes or removal of the Government Guarantee arrangements is critical to maintaining confidence and stability in both retail and wholesale funding markets.**

Significant speculation along with a range of opinions have been reported in the media with respect to the removal or modification of the Government Guarantee arrangements.

Beyond the merits of individual arguments for or against the sooner or later removal of Wholesale Bank Funding Guarantees and the lowering of the cap for the Bank Deposit Guarantee, Investec believes the evidence of the recent volatile period clearly indicates that clarity and certainty as to the Government’s actions is the most important element in ensuring a stable environment is maintained.

Investec believes that to avoid uniformed and potentially excessive reactions by retail depositors and wholesale debt investors, any changes to the current arrangements should be communicated to the market well in advance of their intended implementation.

Additionally, while the market for wholesale debt funding has improved in recent months, this improvement is most significant for the 4 Majors who have been able to undertake wholesale term debt funding in an “unguaranteed format”.

The market for funding has not yet normalised, and is not the same for all issuers, and at present smaller ADIs remain only able to viably source wholesale term debt funding by using the Government Guarantee.

Investec believes that the Government should also consider what international practice is, in respect of guarantee arrangements, as critical factor in determining the timing and nature of the alteration or removal of the Australian Government’s Guarantee arrangements, so as to protect against any potential for a significant outflow of funds from Australia that may seek to “chase the Guarantee” of other jurisdictions.

**Investec suggests the Government consider defining and communicating a simple and “time certain” process for the lowering of the cap for the Bank Deposit Guarantee and the closure of the Wholesale Bank Funding Guarantee Scheme as follows :**

**a) For the Bank Deposit Guarantee the current cap is to remain in place till the close of business 11 October 2011, and from 12 October 2011 the cap shall be set at the level equivalent to the investment amount that signifies a “sophisticated investor” as detailed in Section 708(8) of the Corporations Act (currently being an investment amount of \$500,000).**

**b) For the Wholesale Bank Funding Guarantee Scheme, the Government will provide a minimum notice period of 12 months prior to the closure of the Scheme to new issuance, and the Government will not provide such notice prior to the point in time that funding markets have normalised for all ADIs currently qualifying to utilise the Guarantee. (Investec believes that such “normalisation” is unlikely to be achieved prior to 1 January 2010).**

Please also find attached Appendix 1, which is submitted by Investec on a confidential basis, and which provides a more detailed discussion of the matters addressed in the above summary.



We would appreciate any opportunity to discuss the above matters further through appearance before the Committee.

Yours sincerely,

David Clarke  
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Investec Bank (Australia) Limited

Peter Binetter  
Head of Balance Sheet Management  
Investec Bank (Australia) Limited

