Andrew Buttsworth
Head of Government and Industry Affairs
The Westpac Group
275 Kent Street
Sydney NSW 2000

T (02) 8253 4161
abuttsworth@westpac.com.au

13 July 2009

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

**Inquiry into Bank Funding Guarantees**

Dear Mr Hawkins

The Westpac Group appreciates the opportunity to make a submission to the Committee's Inquiry into Bank Funding Guarantees ('the inquiry'). Whilst noting the inquiry's broad terms of reference, this submission will only canvass matters relevant to the Westpac Group's (Westpac's) operations.

Bank Funding

As with other Australian commercial banks, Westpac funds its lending operations from a mixture of sources, including shareholder's equity, customer deposits and wholesale funding from capital markets. At any given time, this mix contains instruments of varying types and tenors, selected to meet prudential, liquidity and operational requirements. Each component of the funding mixture is raised at different prices, which interact to produce a blended overall 'cost of funds'. This cost of funds forms part of the overall price to customers of the Bank's products and services.

Wholesale bank funding guarantee scheme

The global financial crisis (GFC) has caused widespread and significant disruption in global capital markets. From around late 2007, liquidity, credit and term premia began increasing, resulting in sustained increases in the cost of wholesale bank funding. The collapse of Lehman Brothers in September 2008 resulted in a further loss of trust between financial market participants and other loan counterparties. This loss of trust led to the essentially complete closure of global debt capital markets; meaning that banks such as Westpac experienced extreme difficulties in raising wholesale finance.

To relieve this pressure Governments, including Australia's, moved to guarantee the debt of financial institutions. Since the guarantee became operational on 28 November 2008, Westpac has raised approximately AUD$23bn of wholesale guaranteed debt.

Westpac is not generally a supporter of Government intervention in markets. In the early days of the financial market dislocation, we believed that the strength of the Australian financial and banking system might render an Australian sovereign guarantee scheme unnecessary. However, as other Governments around the world moved to guarantee their weaker banking systems, the Australian Government had little option but to implement similar arrangements. Not to have done so would have put at risk the ability of our banking system to raise funds in capital markets. This is particularly the case given that Australian banks compete for funding with offshore institutions, most of which were the beneficiaries of sovereign guarantees. The inevitable extension of such an outcome would have been widespread credit rationing throughout the economy.

The success of the guarantee scheme is apparent from the fact that such rationing has not occurred. By way of example, the total guaranteed funding raised by Westpac to date would be sufficient to support the provision of 92,000 home loans.[1]

<u>Effect on interest rates</u>

At the time of writing, spreads on guaranteed debt issues are approximately 1% (exclusive of the guarantee fee) lower than those on unguaranteed issues. In other words, the cost of raising wholesale funds *without* the guarantee is still substantially higher than if it is used. Accordingly, it can be inferred that the guarantee has operated to moderate increasing pressures on overall bank cost of funds, with beneficial downstream impacts for our customers.

Westpac believes that as credit markets stabilise, the need for the guarantee will gradually abate. This will be apparent in the converging spreads payable on guaranteed and unguaranteed debt issues. As the price and availability of credit normalises, non-guaranteed debt issues will become relatively more attractive, and at some point, paying the guarantee fee will become an uneconomic proposition. Once this point has been reached, and the guarantee is no longer required to ensure the availability of funds, Westpac would support a co-ordinated lifting of the scheme – or simply the expiration of the scheme through the grandfathering provisions within the enabling legislation. Given the ongoing weakness of offshore banking systems, it is our view that this point is still some way into the future.

<u>Deposit Guarantee Scheme</u>

The deposit guarantee scheme announced by Government was essentially a modification of the previously legislated Financial Claims Scheme. It extended a Government guarantee to deposits of up to $1m per depositor in any one ADI; and also allowed for the guarantee to be further extended to amounts greater than $1m in return for the payment of a fee by the ADI. This scheme will continue until 12 October 2011.

The Westpac Group has historically not supported a deposit insurance scheme in Australia, due to the existence of the depositor preference provisions of the *Banking Act (1959)*, as well as to the potential for moral hazard that such schemes create. Even against the backdrop of the GFC, Westpac's view was that our strength and stability as an institution rendered a deposit guarantee unnecessary. This said, once a guarantee had been extended, we supported the Government's

[1] At an average home loan size of $250 000

decision to make it universally applicable to all ADI’s. To do otherwise would have created differing classes of institutions and led to further unintended outcomes.

Further to this point, we are aware of arguments that various financial and economic distortions have been created through the application of the deposit guarantee to ADIs only, and not to other deposit-style savings vehicles such as cash management trusts. The Group supports the Government’s policy not to extend the guarantee to non-ADI entities; on the basis that these entities are not subject to the prudential regulation framework applying to ADIs, which protects the interests of depositors.

Westpac has also noted public commentary suggesting that the establishment of the unlimited deposit guarantee has led to an outflow of funds from smaller institutions to larger ones; increasing concentration and decreasing competition. Our view is that the opposite is in fact true. That is, in the absence of a guarantee, it is more likely that a greater share of deposit funds would have flowed to larger ADIs (with relatively higher credit ratings) on the basis of the perceived greater security of these funds. On this basis, the Bank’s position is that the guarantee has operated to preserve a level of stability of deposit funds within the system.

As with the wholesale funding guarantee, Westpac supports a review of the deposit guarantee scheme at, or prior to, the time of the legislation’s expiry. Options canvassed at this time should range from Australia’s need for any form of deposit insurance at all, to the substantial reduction of current coverage thresholds.

**Conclusion**

Against the backdrop of financial market events, and in light of the actions of other Governments, the Westpac Group supports the Australian Government’s actions in extending the deposit and wholesale funding guarantees. The evidence is that the schemes have assisted in preserving confidence in the Australian banking system, and in maintaining the supply of credit in the economy at close to pre-crisis levels. We believe that any negative consequences or distortions that may have occurred as a result of the operation of the schemes are outweighed by these positive benefits. We look forward to the removal of the guarantees once circumstances permit.

Once again, thank you for the opportunity to provide this submission. We wish the Committee well with its inquiry.

Yours Sincerely

Andrew Buttsworth