Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 11

Topic: Bank Guarantee

Hansard Page: Written

Senator Joyce asked:

1. With regard to the bank guarantee:
    a) What is the estimated revenue generated by the fees charged for the provision of the bank guarantee?
    b) What is the additional cost of finance to government by providing the bank guarantee?
    c) What is the effect on the supply of finance by providing the bank guarantee?
    d) How will the issue of competition in the banking industry be addressed with the provision of the bank guarantee?
2. What criteria will be used to stress test the banks if the bank guarantee is continued in the medium to long term?
3. How does the Basel Agreement (No.2) apply to Australia?
4. Will APRA describe how the Global Financial Crisis (GFC) has affected the Basel Agreement (No.2)?
5. What methodology will APRA apply to stress test the insurance and banking entities to ensure support of premiums?
6. As the government consistently refers to an increasing frequency and intensity of extraordinary climate events, what advice has APRA offered in relation to mandatory or automatic household insurances on Australian homeowners?

Answer:

1a Revenue from the Guarantee Scheme for Large Deposits and Wholesale Funding was $475.8 million in 2008-09. At the time of the 2009-10 Budget, Treasury estimated Guarantee Scheme revenue to be $1.25 billion in 2009-10.

1b Provision of the bank guarantee does not impose an additional cost of finance on the Government. Although provision of the guarantee now means the Government is carrying an additional unquantifiable contingent liability (reported in the Budget Statement of Risks), the Government's balance sheet is still strong. The Government's AAA rating has been reaffirmed by international ratings agencies since the 2009-10 Budget, and our debt levels are favourable when compared to other advanced economies.

1c This question is best answered by the Reserve Bank. However, as a general comment, the supply of finance by ADIs would be higher where they are able to obtain funding through the use of the guarantee than they would have been able to provide otherwise.

1d The Government's deposit and wholesale funding guarantees are available to all 189 eligible Australian ADIs. By providing broad coverage, the guarantees benefit a large number of financial institutions that, collectively, represent the bulk of the banking services industry, thus supporting competition among a wide range of participants. It is also worth noting that smaller ADIs are the primary beneficiaries of the introduction of the Financial Claims Scheme (which covers deposits up to $1 million free of charge) given their higher proportion of deposits as a share of liabilities.

2. If the guarantee were to be continued for a long period and access to term wholesale markets remained available (as has been the case to date), there would obviously be a lesser need to focus on modelling the impact on ADIs of significantly reduced access to offshore wholesale markets. The response to Q5 covers stress testing more broadly.

3. Please refer to the attached article from APRA's *Insight* Issue 2, 2008 outlining the implementation of Basel II in Australia.

4. A speech by the Chairman of the Basel Committee on Banking Supervision (BCBS) in March 2009 outlined that the Committee is proposing a number of measures to strengthen the global regulation of the banking sector in response to the lessons learned from the GFC. These include:

   – stronger regulatory capital;
   – robust standards for bank liquidity;
   – enhanced risk management, governance and supervision; and
   – greater transparency.

   APRA is currently assessing how it will implement the regulatory changes proposed by the BCBS.

5. APRA has undertaken a range of stress tests to assess the potential impact of changes in various parameters on the capital and liquidity positions of regulated entities. A range of scenarios were covered, including reduced access to funding markets, falls in equity and asset prices, increased impaired assets / losses, widening credit spreads etc.

   When the global liquidity crisis hit in the second half of 2007, APRA's initial focus was to ensure that the ADI sector was able to maintain sufficient liquidity and access to funding. A team was established to assess ADI liquidity and ensure that robust funding plans were in place. APRA also looked to ensure that the ADIs maintained strong capital positions as they expanded their balance sheets following the withdrawal of non-ADI lenders and took off-balance sheet exposures back onto their balance sheets. As impaired assets started to rise over 2008, APRA was continually assessing the expected impact on provisioning and capital.

APRA has also been closely monitoring the impact of financial market developments on life and general insurers and superannuation funds. With the fall in share prices and volatility in the value of market instruments (including credit obligations), APRA has been assessing the ability of regulated entities to handle a range of stress events and has required those entities that would be adversely impacted in these scenarios to have appropriate contingency plans in place. APRA will continue to undertake stress tests of regulated entities and industries and take appropriate supervisory action where necessary.

The APRA Chairman's Opening Statements to the Senate Standing Committee on Economics on 25 February 2009 and 4 June 2009, set out the implications of the global financial crisis for the work and priorities of APRA, including stress testing.

6. The issue of the impact of climate change and major weather-related events on homeowners (through increased risk of loss/damage to homes through flood, storm surge, fires etc) is not a matter for APRA. The type and nature of insurance cover which homeowners have and whether or not it is mandatory/automatic is a matter for consumers in the first instance, and for Government.