

# Labor Senators' Dissenting Report

Labor Senators dispute the accuracy of some of the views expressed in the majority report and are concerned about potential ramifications. Some of the statements made are at best misleading and at worst completely incorrect and may have the potential to negatively impact economic confidence. We believe that in a self-serving attempt to score political points, the report overlooks the serious challenge that the Government faces in steering Australia through the worst global economic downturn in three quarters of a century.

The Governments deposit and wholesale funding guarantees were introduced following the global deterioration in financial markets in September and October 2008. Treasury's submission to this inquiry notes the unprecedented circumstances that give context to this decision.

..the freezing of global credit flows and the introduction of financial sector guarantees internationally threatened the ability of Australian financial institutions to access funding. This had potentially serious implications for the health of individual financial institutions, the stability of the financial system, the flow of credit to Australian household and business borrowers, and consequently Australia's economic growth.<sup>1</sup>

## Introduction of the Guarantees

Firstly Labor Senators would like to highlight one of many inaccuracies and inconsistencies in the majority report and clarify the order of events that brought about the introduction of the funding guarantees.

The Government developed the deposit guarantee in consultation with the Council of Financial Regulators, following discussions going back to early 2008. The Government had announced in June 2008 its intention to introduce a financial claims scheme (FCS) with a cap of \$20,000 per depositor.

On the weekend of the 11-12 October 2008 the G7 and G20 Finance Ministers agreed to urgent and unprecedented action to address the credit crisis, including the strengthening of depositor protection and measures to assist financial institutions to raise funds.

The Government acted upon this decision immediately and on the 12 October the Government brought forward the introduction of the FCS. Legislation establishing the FCS was passed by Parliament on 16 October 2008 and received Royal Assent the following day. The Government noted in its announcement that the guarantee scheme arrangements would be reviewed on an ongoing basis and revised if necessary.

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<sup>1</sup> Submission 22, p5

On 28 October, following further advice by the Council of Financial Regulators, the Government announced that deposits under \$1 million per depositor per ADI would be covered under the FCS whilst deposits above \$1 million would be eligible for coverage under the Guarantee Scheme for Large Deposits and Wholesale Funding Scheme.

Treasury state in their submission to the inquiry that:

*While introduction of the legislation was swift, development of the FCS had been under active consideration by the Council of Financial Regulators since 2004.*<sup>2</sup>

The majority report's assertion that the Government introduced the guarantees following calls for action from the Opposition is an absurd and a desperate attempt to take credit for the Government's ongoing and proven economic credibility.

### **Guarantees are not unlimited**

The report's consistent referral to "unlimited" deposit and wholesale bank funding guarantees is highly misleading. The deposit guarantee is limited to deposits below \$1 million dollars and will operate until 12 October 2011, at which time the cap will be reviewed. Treasury note that "the FCS is intended to remain in place as a permanent addition to Australia's depositor protection and crisis management framework"<sup>3</sup>.

The wholesale funding incurs a fee as outlined in the majority report and is a temporary measure introduced due to the global financial recession that will be removed once conditions normalise. In fact the majority report specifically notes that the Government has so far earned approximately \$0.5 billion in fees.

Labor Senators also note the irresponsible use of inflammatory language utilised in the report. In describing the "aftermath" of the announcement to introduce bank deposit guarantees the report describes "a run on redemptions for those institutions not benefiting from the proposed guarantee".

These types of descriptions are irresponsible in the current climate of economic uncertainty. Labor Senators are concerned that these kinds of remarks could lead to diminishing consumer confidence.

### **Premiums for ADI**

Labor Senators note that, as explained in the majority report, the current premium tiers mean that ADI's with a lower credit rating are facing disproportionately higher premiums on funds than other schemes internationally. Under the current scheme,

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<sup>2</sup> Submission 22, p6

<sup>3</sup> Ibid, p7

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ADIS with credit ratings of AAA to AA- pay 70 basis points per annum, those with credit ratings of A+ to A- pay 100 basis points, whilst others pay 150 basis points.

Labor Senators note the RBA and APRA comment that:

Internationally, fees on comparable schemes have converged at around 90 to 110 points, above the 70 basis point charge for AA rated Australian banks. The Australian fee structure also has a relatively large differential between banks with different ratings.<sup>4</sup>

ADI's such as regional banks, member owned or mutual financial institutions are subject to higher costs of raising funds. These institutions make the salient point that they are subject to the same level of government prudential management as the larger banks and therefore might be regarded at the same risk level. Labor members support a review of the fees charged for the wholesale funding guarantee, with a particular focus on narrowing the range to a more internationally consistent level.

Labor Senators do note that there is a need to plan for a cessation of the government guarantee and that the fees charged do play a role in the orderly withdrawal of this guarantee. This, of course, applies equally to differently rated banks.

### **Recommendation 1**

**Labor Senators recommend the Government review the application and range of existing wholesale funding guarantee fee schedule for ADI's to ensure that the fee levels charged are fair and consistent given contemporary market and economic conditions.**

### **Residential Mortgage Backed Guarantees**

Labor Senators would also like to draw attention to the inconsistencies throughout the report in regards to whether the guarantees go too far or whether they don't go far enough. The majority report says that:

The Committee questions whether, in a country where banks have remained well capitalised, highly profitable and well regulated, it was necessary to take action 'at the more supportive end of those internationally'.<sup>5</sup>

The report also provides some detail on the "moral risk" and potential unintentional consequences of government bank guarantees and refers to the "lip service" paid by the Government in transitioning away from the guarantees.

However it goes off on a tangent to then recommend the introduction of a residential mortgage backed guarantee. So, on the one hand the report argues the existing guarantees have gone too far and should begin to be pared back but on the other hand

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4 RBA & APRA, *Submission 7*, p 4.

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the government should go further and introduce a residential mortgage backed guarantee in addition to the deposit and wholesale funding guarantees. This position advocates a further significant intervention by Government, which could certainly lead to the kind of serious unintentional consequences the majority report had previously found so iniquitous. Labor Senators find these opposing positions difficult to fathom.

Labor Senators nevertheless recognise the serious submissions put forward regarding the market in securities and the ability of smaller ADIs and non ADI institutions to raise and retain funds since the introduction of the bank guarantees. The risk aversion noted since the beginning of the global financial crisis has skewed the securitisation market. It is important to maintain competition and a range of financial products in the marketplace. We believe the Government should reassess the benefits of temporarily guaranteeing Residential Mortgage Backed Securities and therefore broadly agree with the recommendation of the majority report.

### **A very small debt – weathering the storm**

Labor Senators would like to acknowledge and concur with the points made at the conclusion of chapter 3 in the report regarding Australia's very small debt compared to other countries as a result of the global recession. Labor Senators believe table 3.2 highlights the comparative strength of Australia's economic position internationally. This provides further evidence that the Government have acted responsibly and decisively throughout the economic crisis, to support Australian jobs and assist the Australian economy to weather the storm.

**Senator Annette Hurley**  
**Deputy Chair**

**Senator Louise Pratt**