Box A: Government Guarantees on Deposits and Wholesale Funding

On 12 October 2008, the Australian Government announced guarantee arrangements for deposits and wholesale borrowing, following similar announcements in some other countries. Further details of these arrangements – including the announcement of a guarantee fee on large deposits – were released on 24 October following advice from the Council of Financial Regulators. These arrangements were designed to support confidence of depositors in authorised deposit-taking institutions (ADIs) and to help ensure that these institutions continued to have access to capital markets and were not disadvantaged compared to banks in other countries where guarantee arrangements had been announced.

Guarantee on Deposits

The guarantee on deposits is provided under two schemes, the Financial Claims Scheme and the Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding (the Guarantee Scheme).

Under the Financial Claims Scheme, total deposit balances up to and including $1 million per customer held in eligible ADIs – Australian-owned ADIs and Australian-incorporated ADIs which are subsidiaries of foreign-owned banks – are automatically guaranteed by the Australian Government without charge. The Financial Claims Scheme is estimated to cover the entire deposit balances of over 99 per cent of depositors (by number) with eligible ADIs, as most depositors have relatively small balances.

For customers with total deposit balances over $1 million at a single eligible ADI, the ADI can access a government guarantee for that portion of the balance over $1 million through the Guarantee Scheme. To do so, the ADI must apply to the Scheme Administrator (that is, the Reserve Bank of Australia as agent for the Government). The ADI application must include details of the accounts on which the guarantee may be made available, and an undertaking to meet other conditions, including the payment of a risk-based monthly fee by the ADI on the amounts guaranteed. This fee is the same as that applying to wholesale funding (see below). Customers are not obliged to have the guarantee apply to the portion of their total deposit balances over $1 million, and the fee only applies to the amount of each customer's total deposits above $1 million that is guaranteed. In most cases, ADIs recover the fee from depositors.

Deposits with foreign bank branches are not guaranteed under the Financial Claims Scheme, given that branches are not locally incorporated entities and independently capitalised in Australia, but are instead part of the foreign bank incorporated overseas. Foreign bank branches are eligible to participate in the Guarantee Scheme, though there is no fee-free threshold and additional conditions apply. For example, approval requires an attestation that the parent bank is meeting prudential requirements in its home jurisdiction, and there are limits on the term and quantity of guaranteed liabilities based on the branch's liabilities outstanding prior to the

Guarantee Scheme's introduction. The foreign bank branch must also undertake that the funds will not be used to directly support the parent bank.

The Financial Claims Scheme became effective on 18 October and the Guarantee Scheme became operational on 28 November. A temporary guarantee had applied from 12 October, while the relevant legislation was being passed for the Financial Claims Scheme and the rules and operational infrastructure of the Guarantee Scheme were being established. Deposit guarantee arrangements will remain in place until 12 October 2011, ahead of which the Government intends to consider subsequent arrangements. The Government noted in its announcement that the Guarantee Scheme would be reviewed on an ongoing basis and revised if necessary.

Wholesale Funding Guarantee

Eligible ADIs are also able to apply to have their new and/or existing eligible wholesale funding securities guaranteed, for a fee, under the Guarantee Scheme. The guarantee for wholesale funding will operate until market conditions normalise and is subject to the same review procedures as for deposits. As with the guarantee for large deposits, access to the Guarantee Scheme is voluntary and subject to an approval process. A fee is payable on all guaranteed liabilities, with the fee levied monthly. While the same fee applies regardless of the term of the security, fees vary with the credit rating of the ADI (Table A1).

Table A1: Fees on the Guarantee Scheme for Large Deposits and Wholesale Funding

Credit Rating	Fee per annum
AAA to AA–	70 basis points (0.7 per cent)
A+ to A–	100 basis points (1.0 per cent)
BBB+ and below and Unrated	150 basis points (1.5 per cent)

Source: Australian Government Guarantee Scheme Administrator

Only senior unsecured debt instruments of a non-complex nature issued by ADIs are eligible for the guarantee. Eligible ADIs can choose to apply for the Government guarantee for particular securities, or programs, and have other securities unguaranteed. For short-term liabilities, eligible instruments are bank bills, certificates of deposit (including transferable deposits), commercial paper and certain debentures, with maturities up to 15 months. For long-term liabilities with terms to maturity of 15 months up to 60 months, eligible instruments are bonds, notes and certain debentures. Foreign bank branch access to the Guarantee Scheme for wholesale funding involves the same additional conditions and restrictions as outlined for deposits.

International Comparison of Developments in Guarantee Arrangements

Explicit deposit insurance schemes have been common overseas for many years. Faced with the situation of heightened uncertainty and declining confidence in late September/early October 2008, a number of governments around the world responded by increasing the monetary cap on the amount of deposits guaranteed under such schemes (Table A2). For example, in the United States, the cap on insured deposits with eligible institutions was increased temporarily from US$100 000 to US$250 000, while the minimum cap required in European Union (EU) countries was increased from €20 000 to €50 000. Some EU countries including Austria, Denmark, Germany and Ireland went further by providing a guarantee over all deposits, introducing unlimited caps. Most countries that introduced unlimited caps nominated a set period for the arrangements to apply, typically around two years.

Table A2: Changes in Selected Countries' Deposit Guarantee Arrangements

	Previous Limit	Current Limit	Termination Date
Australia	—	Unlimited: first $1 million is free, then voluntary access via Guarantee Scheme	11 October 2011
Austria	€20 000	Unlimited	31 December 2009
Belgium	€20 000	€100 000	
Denmark	DKK300 000	Unlimited	30 September 2010
Finland	€25 000	€50 000	
Germany	€20 000	Unlimited	
Greece	€20 000	€100 000	8 October 2011
Hong Kong	HKD100 000	Unlimited	31 December 2010
Ireland	€20 000	Unlimited	30 September 2010
Netherlands	€38 000	€100 000	
New Zealand	—	NZ$1 million	12 October 2010
Singapore	SGD20 000	Unlimited	31 December 2010
Spain	€20 000	€100 000	
Sweden	SEK250 000	SEK500 000	
Switzerland	CHF30 000	CHF100 000	
United Kingdom	£31 700	£50 000	
United States	US$100 000	US$250 000	31 December 2009

Source: BIS

Around the same time as they extended deposit protection arrangements, many governments also provided guarantees over wholesale funding, partly in response to the Irish Government's decision to do so. The details of the individual schemes vary considerably across countries, although the EU countries agreed to common principles so the approaches they have adopted are fairly similar. While most governments, both within the EU and outside, that provided support to wholesale funding markets did so by allowing private financial institutions to issue government-guaranteed debt, the approach taken in Austria and France differed in that a separate state-controlled agency was established to raise funding, which is then available to be on-lent to eligible private financial institutions.

The fees charged for the government guarantees on wholesale funding are typically based on the credit rating of the issuer (Australia, Canada and New Zealand), or credit default swap premiums (France, the Netherlands, Spain and the United Kingdom). In contrast, in the United States the fee charged is dependent on the term of the instrument but not the rating of the issuer. The fee structure adopted in the Netherlands and New Zealand also depends partly on the term of issuance. In a number of countries, including Canada, New Zealand and the United Kingdom, the fee has been revised lower from initial settings, while in the United States it has been revised higher.

Most governments other than Australia's nominated a set deadline for the availability of the guarantee. While the EU guidelines permit schemes that accept applications for up to two years, the EU countries generally set an application deadline of the end of 2009. In Canada, the United Kingdom and United States, considerably shorter periods were set, though in each case the application cut-off date has since been extended, to the end of October 2009 in the United States and to the end of December 2009 in Canada and the United Kingdom. The instruments eligible for the guarantees generally were limited to a maturity of up to three or five years.

As in Australia, governments have typically restricted the offer of a guarantee to senior unsecured debt instruments that are non-complex in nature. They have also restricted the guarantee to debt issued by certain financial institutions. For example, in Ireland, the Netherlands and the United Kingdom, the guarantee is only available to those institutions that have a significant presence in those countries' financial systems. In the United Kingdom, eligibility is also dependent on an institution having raised, or planning to raise, Tier 1 capital by a certain amount, either by government subscription or from other sources.