

# The Pacific Banking Guarantee Act: mysterious but clever

by Stephen Howes

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ANZ Bank branch in Suva, Fiji during the 1950s

Photo Credit: [ANZ Bank](#)

The Government's [Pacific Banking Guarantee Act 2025](#), passed in September, is mysterious in several ways.

The first mystery is what is being guaranteed. This is not stated in the act, which just requires that the bank receiving the guarantee must be Australian, and the guarantee must relate to the bank's business in the Pacific (including Timor-Leste). The [Explanatory Memorandum](#) appears to be quite misleading on this point. It says that "Any guarantees made will cover low risk exposures of the guaranteed ADI [bank]". But there is nothing in the legislation to require this.

What the Explanatory Memorandum is referring to is not the legislation but the [ANZ deal](#) announced in March last year to which the legislation responds. What does this surprising reference to "low-risk exposures" point to? Why would a guarantee for something that is already low-risk be valuable? This is the second mystery.

A clue to resolving this mystery is provided by the [transcript of a hearing](#) into the bill (as it then was) in August of last year which includes officials saying that "The purpose of the guarantee ... is to release regulatory capital in Australia." This itself sounds paradoxical as guaranteeing a low-risk asset should not release much regulatory capital. But we can perhaps solve the puzzle this way. In any country, loans to the government are the lowest-risk assets any bank can have within that country. But such loans, if to overseas governments, can still be high risk from a domestic regulatory perspective.

In fact, APRA prudential standards require that sovereign exposures to governments with credit ratings of the level held by PNG and other Pacific countries have a risk weighting of 100% when measuring the regulatory capital that banks are required to hold. That risk weighting would go to zero if the Australian government were to guarantee ANZ's holding of those bonds. In other words, this guarantee will exclude from its regulatory capital requirements the entire value of the sovereign

loans ANZ has made in the Pacific.

What this means is that the guarantee is giving an immediate subsidy to the ANZ. This is because any reduction in the regulatory capital requirement (such as the one this guarantee brings about) enhances the profitability of the bank affected, since it will, for example, be able to borrow more to lend more.

The guarantee's being a subsidy leads us to our third and fourth mysteries.

The third one is the [statement by the Assistant Treasurer](#) that the guarantee is “not a subsidy” because the Australian banks that receive it will pay a fee. This is hard to believe. If the fee equals the benefit to the bank of its reduced capital requirement, why would ANZ agree to the deal? Clearly ANZ is paying something for this subsidy. But if this extra profit is offset by the fees there is nothing in it for the ANZ and it would not have signed.

The fourth mystery is the [statement by government officials](#) that the act levels the playing field between domestic banks in the Pacific and international banks. If that were true, then Australia and every other country with multinational banks should offer this guarantee to all their banks in every country in which those banks operate. But obviously Australia doesn't do this, and I'm not aware of any other country that does it either. It simply doesn't make sense to argue that Australian banks need a subsidy from the Australian government to level the playing field for them overseas. When international and domestic banks compete they have a range of advantages and disadvantages. Bank South Pacific (BSP) claimed in its [submission](#) that ANZ already offers lower rates on its PNG loans than BSP does. How could ANZ do that if the playing field is tilted against it?

However, while the official commentary in the lead-up to the passage of this act is disappointing, the actual approach taken is a clever one. Its advantage is that the cost to the taxpayer is virtually zero. Only in the highly unlikely event that Pacific governments default on their bonds will the Australian taxpayer be “on the hook”. This is a deal (albeit on a much smaller scale) similar to the one which underpins the entire multilateral lending system. There, countries with high credit ratings (such as Australia) underwrite the sovereign lending of institutions such as the World Bank and the regional development banks. This costs the high-credit-rating countries almost nothing (there is a small amount of “paid-in” capital but the rest is only “callable”) and the benefits for developing countries are large.

That said, the comparison with the World Bank and similar institutions only goes so far. These institutions operate with a decent amount of transparency. So too should the Australian government. I make my case for this in my next post.

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*Part 1 and **part 2** of this series are based on the **author's submission** to the Senate inquiry held last year into the (then) Pacific Banking Guarantee Bill.*

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