Citizens Electoral Council of Australia

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Independent Political Party

17th of July 2014

Murray inquiry sets stage for Australian bail-in law

The interim report of David Murray's Financial System Inquiry, released 15 July, pushes the case for supposedly solving the problem of too-big-to-fail (TBTF) by implementing "bail-in"—the system which includes confiscating customer deposits to prop up failing banks, Cyprus-style.

Furthermore, Murray recommends the Abbott-Hockey government continue the process commenced under the Gillard-Rudd-Swan governments, of aligning Australia's regulations with the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes, the financial measures to which G20 member countries are committed to comply, including bail-in.

Murray's interim report perpetuates the fraud that bail-in is a solution to TBTF banks, even though bail-in does nothing to reduce the size of the banks such that if they fail they won't damage the rest of the economy. Bail-in is presented as a way to ensure governments won't need to bail out a failing bank, because the cost will be borne by the bank's creditors instead.

(A bank fails when its losses are greater than its capital. In a normal bankruptcy, the bank's assets would be sold up and the proceeds distributed among its creditors, with depositors having a priority claim. In a bail-in, the TBTF bank is kept going, by forcing the creditors, including depositors which are "unsecured creditors", to take a drastic cut on what they are owed, sufficient to reduce the bank's liabilities below its assets, to pretend it is again solvent. In Cyprus in 2013, all depositors lost money, some more than 40 per cent of their total deposit.)

Murray effectively says that failing TBTF banks must be able to be resolved internally, so that there is no need for governments to bail them out. However, it cautions, this means that a bank's creditors (to whom it owes money) will have to accept losses, and the problem is that creditors are often other banks. If one bank's problems causes losses in other banks, it could trigger a wider banking crisis, which bankers call contagion. Therefore, Murray asks, which creditors are best able to absorb losses, in a way that doesn't risk financial instability?

This reasoning pushes the argument to one conclusion: shareholders and depositors.

The report highlights in blue the questions for further discussion: "Is it possible to reduce the perceptions of an implicit guarantee for systemic financial institutions by imposing losses on particular classes of creditors during a crisis, without causing greater systemic disruption? If so, *what types of creditors are most likely to be able to bear losses?*"

What is left unsaid in this argument, is that the specific area where defaulting banks are in danger of damaging other banks, is in their multi-trillion dollar derivatives gambling. When Lehman Brothers' bankruptcy in September 2008 caused it to default on its obligations to its derivatives counterparties in other banks, it blew a massive hole in the global derivatives bubble which triggered the global financial crisis that is still ongoing today. Murray is effectively making the case that a bank's derivatives gambling bets must be honoured above its depositors. (In the past 12 months, derivative gambling globally grew by 20 per cent, to around $2 quadrillion [thousand trillion] by some estimates, setting the world up for a new round of financial meltdown that will be worse than 2008.)

The interim report mentions bail-in four times, as a possible solution to TBTF. It also notes the gaps between Australia's current financial laws, and the FSB's "Key Attributes":

"The gaps identified include: powers to address a distressed foreign bank branch in Australia; the ability to require restructuring of a regulated entity to facilitate resolution; deficiencies in powers to resolve group distress; *a lack of statutory 'bail-in' powers to impose losses on particular creditors*…"

Murray explicitly recommends that the Hockey government continue the Gillard-Rudd-Swan government's process of working with the FSB to close the gaps, which can only mean one thing: finalise the legislation for bail-in powers that the FSB noted in its 15 April 2013 report was "in train in Australia".

Glass-Steagall

There is only one genuine solution to TBTF banks, which protects both the economy and bank deposits: a full, Glass-Steagall separation of investment banking from commercial banking, as mandated in America's 1933 *Glass-Steagall Act*. Under Glass-Steagall, the Big Four banks and Macquarie would be split up into completely separate new institutions: commercial banks that hold deposits and perform the so-called "boring", but safe, banking functions that service the community; and investment banks that engage in risky financial speculation. The two types of banking would have no contact whatsoever: no cross-ownership, no shared directors, no joint ventures. The commercial banks will be super-safe, and the investment banks will know that if their financial gambling goes bad, they are on their own, and will not be bailed out.

Murray's interim report noted that Glass-Steagall is an option, but argued the bankers' case, that a separation would be "expensive", to discourage any moves in that direction. A Glass-Steagall separation would indeed be expensive—to the financial gamblers who are currently able to gamble with depositors' funds, *not* to the depositors.

Make your own submission

All Australians who oppose bail-in and support Glass-Steagall should make that clear to the Murray inquiry, by making a personal submission to the second round of consultations before the deadline of 26 August.

Go to http://fsi.gov.au/consultation/submissions/ and under the section "Which Interim Report observations or question are you responding to?" click on "Stability—addressing too-big-to-fail", and then write your message in the area provided under "Submission summary".

Please reply to the CEC to indicate you made a submission, email to: cec@cecaust.com.au

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As European banks sink, Germany fast-tracks bail-in, but 600,000 Americans petition Congress for Glass-Steagall

The German government has issued four draft bills to introduce the European Union bail-in regime, of seizing deposits to prop up banks, by 2015, a year earlier than the EU had been considering. There can be only one explanation for this rush: fear of an imminent, systemic bank crash.

As this was happening in Berlin, the trans-Atlantic banking system was shaken by the insolvency of Portugal's flagship private bank, Banco Espirito Santo (BES). BES's parent holding company, Espirito Santo International (ESI), sent out e-mails on Wednesday advising clients it had to delay repayment of its short-term debt. The BES rushed to assure its clients not to worry, it would cover payments to those to whom *it* had sold defaulted ESI paper, and Portugal's central bank reiterated that the BES is solvent. Those lies were issued, even as Portugal's *Expresso* weekly reported that holders of Espirito Santo family companies' debt had received proposals to swap that debt for equity in the failing bank. In other words: bail-in!

Portuguese government bond yields rose sharply. BES stock fell nearly 10 per cent, and is now trading at half its value of a month ago. Shares in Portugal Telecom, heavily invested in another Espirito Santo company debt which comes due on 15 July, lost almost 5 per cent. In short, a run on Portugal and its banks is on.

Last week, a bank run in Bulgaria sent tremors through the Eurozone; yesterday, fear fixated on the troubles of two Austrian banks as the potential "Credit-Anstalt" [the 1931 Austrian bank collapse that triggered the Great Depression] of 2014; today, it is Portugal's financial system. Each are precursors of the gigantic global earthquake which American economist and statesman Lyndon LaRouche warned again, yesterday, is about to hit, and which no bail-in, no bail-out, only Glass-Steagall, can prevent.

Glass-Steagall

It is therefore a very welcome development that political pressure is intensifying in the U.S. to restore the *Glass-Steagall Act*, which from 1933 to 1999 completely separated speculative investment banks from commercial banks with deposits, to protect the day to day economy from banking crises by stopping investment bankers from gambling with ordinary people's savings.

On 9 July petitions signed by nearly 600,000 American citizens, calling for the U.S. Senate to pass the *21st Century Glass-Steagall Act*, were delivered to the bill's primary sponsor, Senator Elizabeth Warren, as well as all other United States Senators, asking them to support the bill. The bill was introduced by Sen. Warren along with Sens. John McCain, Maria Cantwell, and Angus King.

"The original *Glass-Steagall Act* served our country well," said Lisa Donner, Executive Director of Americans for Financial Reform, one of the organisations that circulated the petition, in a 9 July release. "It laid the foundation for an unprecedented half-century without financial panics or crises. Just as important, it contributed to a more right-sized banking system and one more focused on serving the economy and the society as a whole, rather than on enriching itself at others' expense."

The release quoted other groups which also circulated the petition: "When banks are allowed to continue gambling with our taxpayer-insured deposits, we are setting up our economy for another meltdown," said Lisa Gilbert, director of Public Citizen's Congress Watch division. "Not a single Wall Street banker has gone to jail for crimes that caused the financial crisis; the least Congress can do is make sure these bankers aren't gambling with our money. It's long past time to reinstitute Glass-Steagall," said Becky Bond, political director of CREDO.

The Citizens Electoral Council is fighting hard to get Glass-Steagall enacted in Australia, to split up the too-big-to-fail Big Four and Macquarie banks, so that the Australian people are protected from the inevitable meltdown of the banks' multi-trillion dollar bets in toxic derivatives and reckless speculation in the property bubble.

The looming global crisis means that such a Glass-Steagall separation is urgent—join the CEC's fight now.

Free copy of CEC's submission to Financial System Inquiry

The CEC's submission details the systemic risks confronting the Australian financial system, and explains why a full Glass-Steagall banking separation is the only solution.

It was submitted with four supporting documents:

- *Memo: The Great Australian Mortgage Bubble*
- *How safe is your super?*
- *Glass-Steagall Now!*
- *Commonwealth National Credit Bank Bill*

Call toll-free **1800 636 432**, or send this coupon to:

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