Citizens Electoral Council of Australia

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Independent Political Party

25th of July 2014

Tell Financial System Inquiry: NO to 'bail-in' of bank deposits!

The Citizens Electoral Council calls on all Australians who oppose the "bail-in" seizure of bank deposits to prop up too-big-to-fail banks, and instead support a Glass-Steagall separation of real banking from financial gambling, to make that loud and clear in a submission to Joe Hockey's Financial System Inquiry.

The deadline for the second round of submissions to the FSI closes on 26 August; FSI chairman David Murray's Interim Report released 16 July called for more submissions on the issue of too-big-to-fail (TBTF) banks, bail-in and alternatives including Glass-Steagall. Murray posed two questions for more discussion:

Is it possible to reduce the perceptions of an implicit guarantee for systemic financial institutions [i.e. TBTF banks] *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?

Depositors are classified as "unsecured creditors" of a bank; if a bail-in law is passed, the unsecured creditors of a failing TBTF bank will be forced to wear its losses, so that the bank can stay afloat, and honour its gambling bets to its derivatives counterparties in other banks and thus avoid "greater systemic disruption".

If enough Australians take the opportunity of this second round of the Financial System Inquiry to make personal submissions, it will send an emphatic message that cannot be ignored.

How to make a submission today

Write a submission, as long or as short as you like, that makes the basic points: you oppose the push for a bail-in law to prop up TBTF banks, and support a Glass-Steagall separation of banking instead (http://cecaust.com.au/Glass-Steagall/). Then you have three options:

1. Go to:
http://fsi.gov.au/consultation/submissions/
Fill in the fields; under the section "Which Interim Report observations or question are you responding to?" click on "Stability—addressing too-big-to-fail"; write a short summary; and attach a Word or similar file in which you've written and saved your statement.
2. Email your submission to: fsi@fsi.gov.au
3. Mail an actual letter to:
   Financial System Inquiry
   GPO Box 89
   Sydney NSW 2001

Please notify the CEC by email: **cec@cecaust.com.au** when you have made a submission. Thank you to those who have already notified us.

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:
CEC, PO Box 376, Coburg, Victoria, 3058.

Please leave all the required details.

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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