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Independent Political Party

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Think your bank deposits are guaranteed? Think again!

A former principal researcher at bank regulator APRA has revealed in a submission to a Senate inquiry that, contrary to government reassurances, *Australian bank deposits are not guaranteed*.

This explosive revelation shreds the government's repeated assurances that its new bill to give crisis resolution powers to the Australian Prudential Regulation Authority (APRA) will not allow the "bail-in" (confiscation) of bank deposits, because they are guaranteed up to \$250,000 by the Financial Claims Scheme (FCS).

In the cover letter to his submission to the Senate Economics Legislation Committee's inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017, Dr Wilson Sy asks Committee chair Senator Jane Hume: "As a matter of urgency, I need to ask: are you prepared to have your savings in bank deposits confiscated to save insolvent banks? What about the millions of voters you represent? How would they react if you allow this to happen to them?"

Dr Sy charges that the bill "gives the Government and APRA new discretionary powers to confiscate bank deposits", and that it should be rejected.

(Dr Sy's submission, "Protect Deposits Not the Fraudulent System", is the first submission posted on the Senate inquiry's website, and can be accessed here: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/CrisisResolutionPowers/Submissions)

As a Principal Researcher at APRA in 2004-10, during which time he was acting Head of Research for a time, Dr Sy is one of the most qualified people to comment on APRA and the powers it will be given by this bill. Both the 2008 global financial crisis and introduction of the Financial Claims Scheme occurred while he was at APRA.

FCS guarantee not activated

The essential point that Dr Sy makes is that the FCS is not an absolute guarantee. He quotes the FCS website, which makes clear that the FCS will only take effect *if* the government activates it *when* an ADI (Authorised Deposit-taking Institution—a bank, credit union, building society etc.) fails. "That is, when a bank fails, i.e. becomes insolvent, the Australian Government or APRA then has the discretion to decide whether or not to activate the FCS", he says. "Hence, it should be emphasised that:

"Bank deposits are not protected or guaranteed at all."

Under the *Banking Act 1959*, Dr Sy explains, APRA is responsible for two potentially conflicting objectives: the protection of depositors **AND** the promotion of financial stability. This depositor protection is "illusory", he asserts, because the *Banking Act* doesn't state which objective has priority.

Under the new bill, however, APRA will have the discretionary power to decide which objective has priority; alarmingly, it will be able to make such a decision "in secrecy". Dr Sy references Subdivision D, Section 11CH

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COUNCIL OF FINANCIAL REGULATORS MINUTES OF THE TWENTY SEVENTH MEETING, 19 JUNE 2009

APRA noted that a pre-funded deposit insurance scheme in Australia would not be insurance in the true sense, as failure by one of the four largest institutions would be likely to exceed the scheme's resources.



Peer Review of Australia

Review Report

21 September 2011

The limit of AUS20 billion per ADI would not be sufficient to cover the protected deposits of any of the four major banks, even though their assets would ultimately be sold to fund any depositor reimbursements if the FCS was used in the resolution process. In any event, there could be circumstances in which these banks would be deemed too big to undergo payout and liquidation.

(p.24) of the bill, which states that APRA may decide that its orders must be kept secret if it is "necessary to protect the depositors of any ADI **OR** to promote financial system stability". (Emphasis added by Sy.) The replacement of "AND" with "OR" confirms that the objectives are in potential conflict. "Therefore", Dr Sy continued, "it is important to recognise that *the Bill allows APRA discretionary powers to decide secretly whether to protect depositors or to promote financial system stability.*"

Quoting a 2012 Reserve Bank of Australia paper, which stated that the priority of regulators, mandated under Commonwealth legislation, is to "pursue financial stability", Dr Sy concludes:

"Therefore, the evidence collected here strongly suggests that *the Bill is designed to confiscate bank deposits to 'bail in' insolvent banks to save the financial system.*"

Can't be funded

Dr Sy's revelation is further, damning evidence that the FCS is not a real guarantee. The Citizens Electoral Council had already exposed in 2014 that, by the regulators' own admission, the FCS doesn't have the money to guarantee deposits in any of the Big Four banks, which hold 80 per cent of all deposits! This was first acknowledged in a 19 June 2009 meeting of Australia's Council of Financial Regulators, comprising APRA, ASIC and the Reserve Bank, which noted in its minutes that a failure of one of the Big Four banks would "exceed the scheme's resources". Later, the Financial Stability Board in Basel, Switzerland, which is in charge of imposing a bail-in regime worldwide, noted in its 21 September 2011 "Peer

Review of Australia” that the government’s \$20 billion provision per bank “would not be sufficient to cover the protected deposits of any of the four major banks”, which each have more than \$400 billion in deposits. The CEC presented this evidence in its submission to the Senate committee inquiry.

Defeat the APRA bill

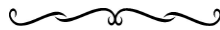
Most members of parliament are assuring their constituents that the APRA bill—which virtually none would have read—does not mean deposits will be able to be bailed in, because deposits are guaranteed under the FCS. Dr Sy’s revelation explodes that myth. This is not an academic question. With all signs pointing to a near-term collapse of the so-called “everything bubble” comprising property markets in Australia and elsewhere, the US stock market, Bitcoin, and the US\$1.2 quadrillion global

derivatives trade, a looming global financial crisis threatens Australia’s banking system. It is urgent, therefore, that Australians demand their MPs reject this bill outright, and go with the Glass-Steagall banking regulation instead, which guarantees deposits and financial stability by separating commercial banks with deposits from all forms of financial speculation.

What you can do

The Senate Committee is expected to hold hearings in either late January or early February, by which time it is imperative that every MP and Senator is confronted with the truth about this bill.

You can help by delivering copies of this release and the CEC submission, and Dr Sy’s submission, to your federal MP and as many Senators as you can by the end of January, and insist they read them and respond to you in writing.



Replace APRA and ‘bail-in’ with a Glass-Steagall separation of Australia’s banks

The Citizens Electoral Council of Australia’s Submission to Senate Economics Legislation Committee inquiry: Financial Sector Legislation Amendment (Crisis Resolution Powers and other Measures) Bill 2017 [Provisions], 18 December 2017

Terms of reference

- To understand exactly what capital instruments are covered by the Bill.
- To understand what consultation process APRA would be required to undertake before making determinations under the Bill.
- To understand what power the executive and/or parliament is ceding to APRA.
- To understand the possible implications to market concentration in the banking sector.

The Australian Parliament is being asked to legislate for so-called bank “bail-in” powers for the Australian Prudential Regulation Authority (APRA), through the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017. Treasurer Scott Morrison presented this aspect of the bill as “technical” amendments, but parliamentarians cannot assess their implications without first understanding the nature and intent of the global bail-in system that has been developed since the 2008 financial crisis.

The September 2008 bankruptcy of Wall Street investment bank Lehman Brothers, and subsequent chain-reaction meltdown of insurance giant AIG, a host of other mega-banks in the USA and Europe, and hundreds of regional and smaller US banks, led to massive bank bailouts by governments and central banks. The US government put up US\$700 billion for an emergency rescue package called the Troubled Asset Relief Program, the UK government nationalised two of its biggest banks, and other governments made similar interventions; in Australia the Rudd government guaranteed the banks’ overseas borrowings and domestic deposits. On top of this, the world’s major central banks, the US Federal Reserve, Bank of England, European Central Bank, and Bank of Japan, commenced electron-

ically “printing” enormous quantities of money through quantitative easing (QE), now up to US\$16 trillion, to prop up the global banking system. The justification was that the collapse of Lehman Brothers had demonstrated that some banks were too big to fail (TBTF).

The taxpayer-funded bailout of the banks was deeply unpopular, not least because the banks are closely identified with the neoliberal economic doctrines of free markets and self-sufficiency, which didn’t apply to them in the crisis. Partially in response to this reaction, governments at the London G20 summit in April 2009 charged the Financial Stability Board (FSB) based at the Bank for International Settlements (BIS) in Basel, Switzerland, with developing a system for resolving financial crises that would ensure financial stability, end TBTF, and not require government bailouts. The result was the FSB’s “Key Attributes of Effective Resolution Regimes”, announced in October 2011. The centrepiece of the FSB’s resolution system was the new concept of bail-in, which mandated the “write down” of a failing bank’s liabilities to unsecured creditors, including depositors, to the “extent necessary to absorb the losses”. The FSB chairman who oversaw the development of the bail-in policy, Mario Draghi, then took over as chairman of the European Central Bank (ECB), and in March 2013 forced the nation of Cyprus to

be the first to bail in deposits in its banks, with devastating consequences for the Cypriot people and economy.

Conflict of interest

The FSB's bail-in regime represents a massive conflict of interests. It is, in fact, a bankers' solution to the financial crisis that bankers caused! The original notion of bail-in was invented by two CS First Boston derivatives salesmen, Paul Calello and Wilson Ervin, as they participated in the infamous September 2008 weekend lock-up at the headquarters of the New York Federal Reserve to work out how to respond to the collapse of Lehman Brothers. Their idea had nothing to do with the FSB's ostensible purpose of averting bailouts and ending TBTF. By their own admission they were simply concerned with devising a way that future TBTF banks like Lehman Brothers could be stopped from declaring bankruptcy, so they wouldn't trigger knock-on collapses among their derivatives counterparties. Their solution was not to restrict derivatives speculation, but to make a failing bank's unsuspecting creditors absorb the losses, so it would remain solvent.

From this inception of the idea, the bail-in policy was developed by the Bank of England and the BIS-FSB. The process was dominated by individuals with reputations for representing the interests of the banking system. First and foremost was Mark Carney, who became chairman of the FSB in 2011 and Governor of the Bank of England in 2013. Carney is a former Goldman Sachs executive and, befitting that bank's reputation, a devotee of the free-market ideology that drove the financial deregulation which unleashed the speculation that caused the GFC. Upon his appointment as Governor of the Bank of Canada in 2008 Toronto's *Globe and Mail* had commented that "there's no doubt that Mr Carney believes that markets should largely be left unhindered to determine the direction of the economy".

Other key individuals in the development of bail-in include: former deputy governor of the Bank of England Paul Tucker, whose closeness to the private banks became a scandal in 2012 when the LIBOR rate fixing was exposed; and the aforementioned Mario Draghi, current chairman of the ECB and Carney's predecessor as FSB chairman during its development of the bail-in policy, who, like Carney, is also a former Goldman Sachs executive.

Unworkable

Aside from being a conflict of interests, bail-in cannot, and does not, work to resolve banking crises. In April 2013, following the Cyprus bail-in, the former deputy director of Japan's Ministry of Finance, Daisuke Kotegawa, denounced the bail-in policy as "stupid" for destroying the trust that depositors place in banks. Mr Kotegawa was eminently qualified to comment, as he had successfully overseen the resolution of a serious banking crisis in Japan in 1999 in a way that averted a global derivatives meltdown. Speaking to a Schiller Institute conference in Frankfurt, Germany, he said, "They have been trying to introduce a system whereby depositors are also asked to lose part of their deposits. This will completely destroy confidence in the financial system, and thereby aggravate the financial crisis. ... *It violates the basic notion of how a bank can exist and operate.*"

The European experience of bail-in has borne this out. The announcement of bail-

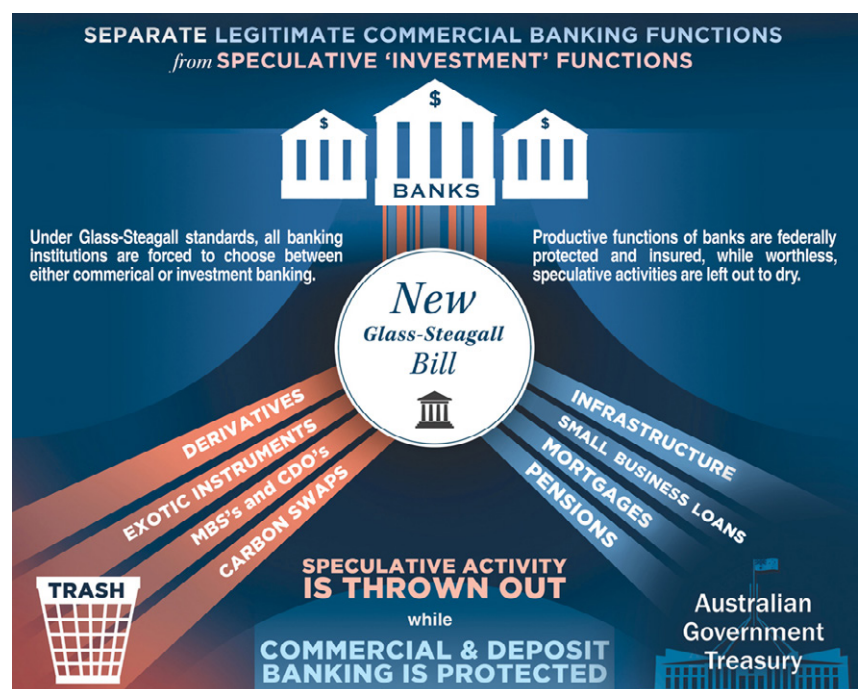
in in Cyprus sent such a shock wave of panic throughout the rest of Europe, where many other banks were similarly failing, that the EU authorities were forced to make a partial retreat, and only bail in "uninsured" deposits above €100,000. Subsequent European bail-ins—in Italy, Portugal and Austria—did not apply to deposits per se, but to forms of hybrid securities and contingent-convertible bonds which disproportionately affected pensioners who had invested their money in those instruments under the false assurance that they were as secure as deposits. Consequently, the bail-ins were enormously damaging to confidence, and government bailouts were still required. Despite, but actually because of, the widespread use of the bail-in tool, Europe's banking crisis remains unresolved to this day.

Glass-Steagall

Bail-in is more than stupid and unworkable—it should be regarded as a financial scam. It destroys the financial security of innocent bank customers and investors, but allows the banks to continue to engage in the dangerous financial speculation that caused the 2008 crisis, using their customers' deposits. Its actual intention was not to avert bank bailouts, as claimed, but to avert any moves by government to respond to the financial crisis by restoring the Glass-Steagall separation of commercial banks that hold and lend deposits, from investment banks, insurance companies and other financial services that speculate in financial securities.

The 66-year record (1933-99) of the US *Glass-Steagall Act*, under which there were no systemic banking crises in the United States, proves that it would achieve all of the FSB's ostensible goals of genuine financial stability, and the end of TBTF banks and the need for expensive taxpayer bailouts, while providing absolute protection for depositors, instead of sacrificing deposits. However, because it would do so by stopping banks from effectively gambling with deposits, the banks vehemently oppose it.

From the onset of the financial crisis, there was a concerted push to restore Glass-Steagall in the USA, and establish it worldwide, which the banking industry lobbied very hard to derail. In the United States Wall Street banks helped to draft that country's complex post-crisis financial



reform legislation, the 848-page *Dodd-Frank Act* (2010), to ensure it didn't restore Glass-Steagall. This required complicated provisions that were claimed would achieve the same outcome as Glass-Steagall, but without requiring a full separation. Among these were bans on insured deposit-taking institutions trading in derivatives "swaps", and on banks trading on their own account (the "Volcker rule"). Even these limited restrictions were too much for the banking industry, however. The ban on swaps was rescinded in 2014, following a Wall Street lobbying offensive led by JP Morgan Chase, and now the same banks are lobbying to end the Volcker rule.

In the United Kingdom, the push for Glass-Steagall attracted enormous political support. It was led by Lord Nigel Lawson, the Chancellor of the Exchequer in the Thatcher government in 1986 who had overseen the so-called "Big Bang" deregulation of the financial sector, which ended the UK's informal separation of commercial and investment banking. Lord Lawson recognised that the 2008 crash proved that allowing commercial and investment banking to merge had been a mistake. The support was so strong that the government of Conservative Prime Minister David Cameron intervened to protect his City of London donors from Glass-Steagall, by appointing the Vickers inquiry, which recommended the limited "Claytons" separation called ring-fencing, instead of full-blown Glass-Steagall. Nevertheless, 445 members of the House of Commons and House of Lords voted to amend the *Financial Services (Banking Reform) Act 2013*, which legislated ring-fencing and bail-in, to enact a full Glass-Steagall separation. The amendment was only narrowly defeated, by a mere nine votes in the Lords, following intense lobbying by banks.

Comments on terms of reference

1. To understand exactly what capital instruments are covered by the Bill

The bill enhances APRA's powers to convert or write off, a.k.a. bail in, capital instruments. These instruments include hybrid securities that have contractual bail-in provisions, which are counted as Additional Tier 1 and Tier 2 capital. Under so-called Basel III regulations from the BIS, APRA has already adopted the need for AT1 and T2 capital to be bailed in, in its Banking (Prudential Standard) Determination No. 1 of 2014. This bill removes any legal obstacles to such a bail-in, as the explanatory memorandum states: "5.11 The Bill amends the Industry Acts to provide increased certainty in relation to the conversion and write-off of capital instruments, including amendments to provide that ... conversion or write-off can happen despite any impediment there may be in ... *any domestic or foreign law...*" (Emphasis added.)

This provision alone is grounds for Parliament to reject this bill, for the reason that it puts at risk hundreds of thousands of Australian retail investors. These are unsuspecting so-called "mum and dad" investors to whom APRA has allowed the banks to aggressively sell hybrid securities. APRA's intentional complicity in this is a scandal, which proves it is not a fit regulator. As the CEC revealed in an 8 July 2016 release, "Warning to Australian investors: Beware hybrid securities, a.k.a. 'bail-in' bonds" (Appendix A), the Bank of England forbids UK banks from selling equivalent hybrid securities to UK retail investors because they are unlikely to understand their risks, yet APRA has allowed Australia's banks to target such inves-

It is significant that the supporters of Glass-Steagall include many experienced and former bankers, who took stock of the 2008 crisis and acknowledged that merging commercial and investment banking had been a mistake. These include the two former leaders of Citigroup, Sandy Weill and John Reed, who organised the merger of Citibank and Travellers Insurance in 1998 which was used to convince the US Congress to repeal Glass-Steagall. In the UK, former investment banker Lord Forsyth of Drumlean noted that only Glass-Steagall, not ring-fencing, would stop banks from speculating with deposits, because "bankers are extremely adept at getting between the wallpaper and the wall. If they can find a way to get around something they will." In Australia, the former CEO of National Australia Bank, Don Argus, said in *The Australian* of 17 September 2011: "People are lashing out and creating all sorts of regulation, but the issue is whether they're creating the right regulation.... What has to be done is to separate commercial banking from investment banking."

Unless Glass-Steagall is implemented in Australia and worldwide, bail-in will only be the beginning, because it doesn't address the reckless speculation in debt and toxic and fraudulent derivatives instruments that is driving financial crises. The financial system will lurch from crisis to worse crisis, and the banking industry will extort from governments increasingly complicated and convoluted measures to prop it up, which will cost everyday citizens dearly. This is not an issue for banking technocrats, but for elected representatives, to intervene and establish clear and rock-solid financial regulations that protect the functioning of the real economy and the financial security of their constituents.

tors, preying on their ignorance with offers of high interest rates of sometimes around 8 per cent.

The CEC is not alone in this warning. The now former Australian Securities and Investments Commission (ASIC) chairman Greg Medcraft has called the exposure of Australian retail investors to hybrid securities a "ticking time bomb". In testimony to the Senate Economics Legislation Committee on 26 October, Mr Medcraft revealed that Australian banks have sold \$43 billion worth of hybrid securities, mostly to retail investors, and in parcels as small as \$50,000. This means that upwards of half a million Australian retail investors, in the form of self-funded retirees and self-managed superannuation fund operators, could be holding these instruments.

Mr Medcraft implied what the CEC is charging: APRA has set up these retail investors to unknowingly absorb the banks' losses. "There are two reasons we believe a lot of the retail investors buy these securities", he said. "One is they don't understand the risks that are in over 100-page prospectuses and, secondly—and this is probably for a lot of investors—they do not believe that the government would allow APRA to exercise the option to wipe them out in the event that APRA did choose to wipe them out. ... Basically, they can be wiped out—there's no default; just through the stroke of a pen they can be written off. For retail investors in the tier 1 securities—they're principally retail investors, some investing as little as \$50,000—these are very worrying. *They are banned in the United Kingdom for sale to retail.* I am very concerned that people don't understand, when you get paid 400 basis points

over the benchmark, that is extremely high risk. And I think that, because they are issued by banks, people feel that they are as safe as banks. Well, you are not paid 400 basis points for not taking risks...." (Emphasis added.)

Deposits?

It is bad enough therefore that this bill clears the legal obstacles to APRA ordering the bail-in of hybrid securities. The question is: does the broad language of the bill allow APRA to also bail in bank deposits? For a number of years, the government has forcefully denied this possibility; however, before considering the terms of the bill in this regard, understand why it is a real suspicion.

All over the world, where governments have legislated bail-in regimes, *they apply to deposits*. As stated, in Cyprus in March 2013 bail-in at first applied to *all* deposits, but under fierce opposition the EU authorities retreated slightly to bail in only uninsured deposits over €100,000. On 25 March 2013 the head of the Eurozone finance ministers Jeroen Dijsselbloem said the Cyprus resolution would become the "template" for all of Europe. By 1 January 2016, the EU had enacted a Europe-wide bail-in regime called the Bank Recovery and Resolution Directive (BRRD), which applies to all deposits above €100,000 in the EU, and above £75,000 in the UK. The pledge not to touch insured deposits is already being watered down, however. On 8 November 2017 Mario Draghi's ECB proposed to amend the BRRD to allow a "pre-resolution moratorium" freezing the withdrawal of *all* deposits, for the simple reason that, due to their experience, bank customers will rush to withdraw their deposits if they know the bank is going to be put through a "resolution" (Appendix B).

In the United States, the *Dodd-Frank Act* provides for the bail-in of deposits over US\$100,000. And in New Zealand, the Reserve Bank of New Zealand's Open Bank Resolution (OBR) bail-in regime allows for the bail-in of *all* deposits, as NZ has no deposit guarantee. The RBNZ calls depositors "investors" who have "accepted the risks". It is important to note that the banks to which NZ's OBR applies are subsidiaries of Australia's major banks!

So, if the government is to be believed, even though bail-in applies to deposits in virtually every other jurisdiction with bail-in, including to the deposits in the NZ subsidiaries of Australia's banks, it will not apply to Australian bank deposits.

The language of the bill does not reinforce this assurance. Under *Section 11CAA Definitions*, it states:

In this Subdivision:

conversion and write-off provisions means the provisions of the prudential standards that relate to the conversion or writing off of:

- (a) Additional Tier 1 and Tier 2 capital; or
- (b) *any other instrument*.

Under the *Banking Act 1959*, APRA can determine prudential standards without the need for new legislation. Section 5.14 of the explanatory memorandum raises the possibility that a future determination of prudential standards could involve new definitions of capital for the purpose of conversion or write-off. It states: "Presently, the provisions in the prudential standards that set these requirements are referred to as the 'loss absorption requirements' and requirements for 'loss absorption at the point of non-viability'. The concept of 'conversion and write-off provisions' is intended to refer to these, *while also leaving room for future changes to APRA's prudential standards, including changes that might refer to instruments*

that are not currently considered capital under the prudential standards." (Emphasis added.)

What guarantee is there in the bill that "any other instrument" could not in the future be defined in the prudential standards to include deposits? Since 2003 APRA has had the power to order a bank not to repay deposits under certain conditions, including if, as specified in the *Banking Act*: "there has been, or there might be, a material deterioration in the body corporate's [bank's] financial condition"; or "the body corporate is conducting its affairs in a way that may cause or promote instability in the Australian financial system". The bill strengthens this section of the *Banking Act*. A legal analysis of the bill commissioned by the CEC noted: "It is a relatively smaller step to then convert or write-off what the ADI has been prohibited from paying out [i.e. deposits]. ... Unless there was a prohibition in the Bill against the making of any determination to declare deposits to be capital capable of conversion or write-off, the worry would be that APRA could make such a determination."

Financial Claims Scheme

The government repeatedly claims to constituents who are concerned about the bail-in threat that they are protected by the Financial Claims Scheme, which guarantees deposits per individual per authorised deposit-taking institution (ADI) up to \$250,000. However, even if only deposits over \$250,000 were bailed in, that would still be destructive to many businesses, charities, and public agencies, and hence to confidence in the banking system. Moreover, there is a very real question of whether the FCS is any guarantee at all. Both the 19 June 2009 meeting of Australia's Council of Financial Regulators, which includes APRA, ASIC and the Reserve Bank, and the FSB in its 21 September 2011 "Peer Review of Australia" noted that the government's \$20 billion provision per ADI would not be sufficient to honour its deposit guarantee in the event of a failure of any of the Big Four banks.

2. To understand what consultation process APRA would be required to undertake before making determinations under the Bill

Introducing the bill into Parliament on 19 October, Treasurer Scott Morrison acknowledged it is intended to bring Australia into compliance with the BIS-FSB bail-in regime. It will enhance the "efficacy of the legal framework for the conversion of capital instruments under the Basel III framework", he said, and will "ensure that Australia's regulatory infrastructure is in line with international best practice".

The BIS is a secretive, supranational institution known as the "central bank of central banks", with a dark past that includes collusion in Nazi war crimes. Its Basel headquarters boasts the same level of legal and political autonomy as the United Nations Organisation in New York City, and it functions as a financial authority outside of the authority of national governments. Through its Basel process of hosting the deliberations of central banks and financial regulators, the BIS directs banking regulation worldwide. It insists that the national regulators which enforce its directives, such as APRA, must be "independent" of governments. This is expressed in the BIS's Basel Committee on Banking Supervision's "Core Principles of Effective Banking Supervision"—issued in 2012 when current APRA chairman Wayne Byres was the Secretary General of the committee—which stated that there must be "no government or industry interference that compro-

mises the operational independence of the supervisor”.

In a financial crisis, when the proposed resolution powers will be used, APRA and the BIS-FSB structure are hard-wired to represent the interests of the banks. Former ASIC chairman Greg Medcraft observed this fact in an interview published in the 13 November *Australian Financial Review*: “The role of APRA is to protect the entity, the bank, and ASIC’s role is to protect consumers and investors. Sometimes what may be good for an entity and its profitability and its soundness may not be particularly good for consumers and investors.” Democratic governments, however, would necessarily be mindful of the impact of their actions on the public. Extreme resolution measures such as bail-in are enormously damaging to the public; European governments which have been forced to order bail-ins have subsequently been voted out of office.

From this it can be concluded that APRA would regard Parliament as a potential obstacle to a resolution, and would have no intention of consulting with Parliament. It would be assisted in this by its extreme secrecy restrictions, which are enhanced in this bill.

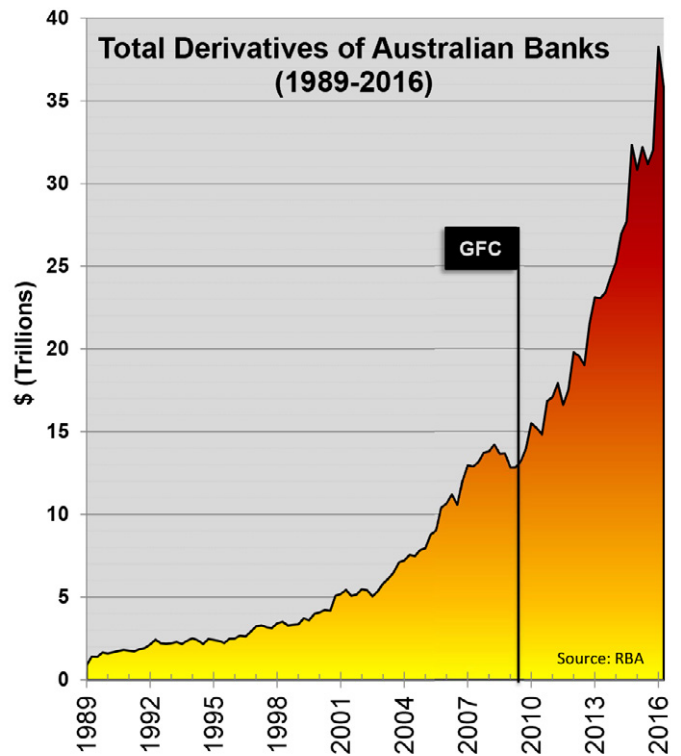
3. To understand what power the executive and/or parliament is ceding to APRA

As above, the government and Parliament are ceding power not just to APRA, but the BIS-FSB apparatus it is directed by. They are effectively being handed control of Australia’s response to a financial crisis, in a way that strips the Australian people of their only protection—democratic accountability. The conflicted banking technocrats at the BIS, FSB and APRA regard democratic accountability as an obstacle to a resolution, but only because their idea of a resolution is what is in the interests of the banks. The government is responsible for the welfare of the whole population, and it must not renege on this responsibility by ceding power to a technocratic banking dictatorship.

4. To understand the possible implications to market concentration in the banking sector

That APRA has been a disastrous regulator is evidenced by the appalling behaviour and practices of the banks under its supervision, which drove the demands for a royal commission into the banks. Under APRA’s supervision, Australia’s banking system has become more concentrated than ever, with just the Big Four banks controlling 80 per cent of the industry. And the business of those banks has become more concentrated than ever, with mortgages accounting for more than 60 per cent of the lending of each of them. APRA actively incentivised this outcome, by its early 2000s adjustment of capital risk weights to make mortgages far more profitable than any other type of lending. This has fuelled one of the biggest property bubbles in the world, which is proportionally even bigger than the US property bubble that triggered the GFC when it burst in 2007-08. It has also starved productive industries, small businesses and regional Australia of credit, and incentivised the banks to aggressively foreclose on viable businesses and farms to claw back credit for redeploying into the housing bubble.

APRA’s greatest failing in this regard is it has allowed a concentration of extreme risk to build up in Australia’s banking system, in the form of derivatives speculation. In the period that APRA has been the bank supervisor, total Australian bank derivatives have exploded, from \$3.1 trillion in 1998, to \$14 trillion at the time of the 2008 GFC, to \$36.7 trillion today! The banks claim that they are plain



vanilla derivatives contracted in the normal business of banking, but this explanation does not explain their incredible, accelerating growth. The majority of these contracts are interest-rate and currency swaps, related to the banks’ speculation in the housing bubble, which would be justified as reducing risk; but in fact, as the experience of the GFC proved, derivatives amplify risk. Measures have been taken since the GFC to ostensibly address the derivatives risk, such as the requirement that over-the-counter (OTC) derivatives go through Central Counter-Parties (CCPs), but many experts, including US President Donald Trump’s economics adviser Gary Cohn on 15 October 2017, have warned that CCPs have now become a source of systemic risk in the financial system. Under the FSB’s bail-in regime, derivatives obligations have priority over other bank liabilities, because of the risk that a default could trigger contagion in the global financial system. In other words, ordinary savers will lose their deposits, so counterparties to the derivatives bets that caused the financial crisis can be paid.

Conclusion

Leading experts and organisations, including most recently economist Claudio Borio of the Bank for International Settlements on 3 December, are warning that economic and financial conditions are similar to those which triggered the crash in 2008. Not only will Australia not dodge the next global crisis, there is a real chance that a collapse of the Australian housing bubble could trigger it. The issue of the APRA bail-in powers in this bill, vs. a Glass-Steagall banking separation, is therefore not an academic exercise. It has urgent, life-or-death implications—just ask the European victims of bail-in.

The CEC urges the committee to act on behalf of all of the Australian people, by rejecting this bill, and using the committee to lead a process of establishing a Glass-Steagall separation of the Australian banking system that can guarantee financial stability and protect Australians’ financial security.

Warning to Australian investors: Beware hybrid securities, aka 'bail-in' bonds!



8 July 2017—Australia's big banks are careening along a cliff's edge at breakneck speeds with ordinary investors strapped to their bumpers as human shock absorbers.

Bank regulator APRA is allowing the big banks to sell to unsuspecting Australian investors products that are illegal for banks in other countries to sell to anyone but other financial institutions.

The products are hybrid securities known variously as CoCo (contingent convertible) bonds or bail-in bonds. These complex securities are sold as bank bonds, often bearing a very high interest rate. However, buried in their fine print are numerous triggers that, if the bank gets into trouble, convert the bonds into far less valuable or even worthless shares in the bank.

The investors think they are first in the line of bank creditors and will have their bonds honoured even if the bank fails, only to discover they are holding worthless shares which may or, more likely, may not come good.

Australia's banks are aggressively selling these bail-in bonds to so-called retail investors—mums, dads and retirees. To suck them in, the predatory banks are offering amazingly high interest rates. In February CBA issued a \$910 million tranche of hybrid securities at 7.5 per cent interest—a very generous 5.2 percentage points higher than the standard bank rate. Most hybrid issues are around 3 percentage points higher than the bank rate. "CBA is offering the fattest premium in history", Jonathan Shapiro observed in the 27 February *Australian Financial Review*.

As one market watcher asked, "If you are a self-funded retiree desperate for a return in this low-interest climate, and Australia's biggest and 'strongest' bank, CBA, offers you 7.5 per cent interest on bonds, are you going to think twice about the fine print? Probably not."

In recent weeks, Westpac, NAB and ANZ have all announced big hybrid bond issues, ANZ's being the first US dollar-denominated hybrid since 2008.

In 2014 the UK's Financial Conduct Authority stopped British banks from selling bail-in bonds to retail investors because of the risks associated with the securities that such investors might not readily understand.

It is therefore shocking that in Australia, APRA is allowing the banks to target retail investors with the same products. The banks list their hybrids on the Australian Securities Exchange (ASX) and sell them to individuals via stockbrokers. In his February article the AFR's Shapiro noted they are especially targeting self-managed super funds which "have proved to be a deep pool of capital. These investors know and trust the banks ..." (Emphasis added.)

This trust in the banks is built on a scaffold of lies peddled by bankers, politicians and the media. Most retail investors wouldn't know, for instance, that:

During the 2008 global financial crisis when the public was reassured Australia's banks were "sound" the Big Four and Macquarie spent the weekend of 11-12 October on their knees begging the Rudd govern-

ment for guarantees, without which they would be "insolvent, sooner rather than later".

Following the GFC, when globally the volume of gambling in derivatives levelled off and even shrank, the derivatives gambling of Australia's banks skyrocketed, doubling between 2009 and 2015 from \$14 trillion to \$28 trillion (now \$32 trillion); in 2012 CBA, which had the fastest growth in derivatives gambling, suddenly and suspiciously stopped disclosing its true derivatives position.

The big four banks are so exposed to the property bubble in Australia that, when one of any number of triggers bursts that bubble, Australia's banks will suffer the same fate as Ireland's banks in 2008 and go bankrupt.

The hybrids are called "bail-in bonds" because APRA is expected to let Australia's banks count them towards their TLAC—total loss absorbing capacity—which is a requirement of the global "bail-in" regime that the Bank for International Settlements is dictating to the world. Bail-in is intended to preserve Too Big To Fail (TBTF) banks by ensuring that significant losses from their reckless speculation are worn by ordinary depositors and investors, not the banks, so that such losses don't trigger another 2008-style meltdown.

Hence the human shock absorber analogy. The banks are knowingly selling a product that will make unsuspecting investors wear their losses so they can continue recklessly gambling in the property bubble and derivatives. Australia as yet doesn't have depositor bail-in, because the CEC exposed and defeated the plans for such legislation in 2013-14, so APRA is bringing in bail-in through the back door.

Solution: Investigate the banks; Glass-Steagall

The CEC has been warning about bail-in bonds in our weekly Australian Alert Service magazine since the start of the year, after thousands of Italian investors were wiped out by similar products. In the lead-up to and during the federal election, a number of political parties including Labor, the Greens, NXT, Jackie Lambie, and One Nation put an investigation of the banks on to their party platforms. Such an investigation must include APRA's plans for bail-in.

The immediate solution is clear: Glass-Steagall legislation to split up the big four banks and any other conglomerate banks into completely separate institutions—dedicated deposit-taking banks that serve the real economy and are protected by the government on one side, and investment banking, wealth management, stockbroking and insurance businesses on another. Bail-in will destroy people to save banks; Glass-Steagall will save people by dismantling TBTF banks and ensuring real banks are truly sound. The CEC is leading, in Australia, the global campaign to enact Glass-Steagall as the first step to solving the global financial mess that is about to erupt into another crisis. If you want to survive it, and want your country to survive that crisis, join the CEC and campaign for Glass-Steagall.

Europe to extend ‘bail-in’ to guaranteed deposits—don’t give crisis powers to banking technocrats!



29 Nov. 2017—When the government and financial authorities assure you your deposits are guaranteed, don’t believe them. They have proven time and again that in a financial crash they will put the survival of banks and their powerful owners first. The latest example of this is a European Union move to amend existing “bail-in” legislation to enable bank regulators to freeze even bank deposits that are covered by a government guarantee. The derivatives speculators who cause banking crises will be exempt from the EU’s “moratorium” on bank withdrawals, but not so the people’s daily access to their savings!

Presently the Australian government is trying to legislate crisis resolution powers for the Australian Prudential Regulation Authority (APRA) that could be used to bail in depositors, all the while assuring the public their deposits are guaranteed up to \$250,000. Europe’s experience shows that once regulators go down the path of bail-in there is no end, and in their desperation to prop up a failing system they will look for ways to grab everything they can.

‘Pre-resolution moratorium’

An 8 November European Central Bank (ECB) opinion paper “on revisions to the Union crisis management framework” declares open slather on deposits and unsecured debt. The proposal would amend the EU-wide Bank Recovery and Resolution Directive (BRRD), which as of 1 January 2016 introduced a bail-in regime to Europe, to include a “pre-resolution moratorium tool”. This would allow banking authorities to freeze deposits for five days in financial institutions that are “failing or likely to fail”—including those guaranteed by governments. In the EU that means all deposits up to €100,000.

The moratorium tool would allow unelected banking technocrats to “suspend payment and delivery obligations” on deposits, and thereafter determine whether depositors can “withdraw a limited amount of deposits on a daily basis” to cover the cost of living. Incredibly, this is described as a “limited exemption on a discretionary basis”, i.e. the freeze on withdrawals would be the rule, access to your own savings for living expenses would be the exemption. The ECB claims the new “far-reaching powers” will be “exercised only in extreme circumstances”, where “the competent authority determines that it is not possible to apply less intrusive measures”.

The moratorium won’t be a one-off. The ECB concedes it could repeat such five-day freezes under extenuating circumstances, which it assuredly would have to under conditions of a global financial crash; the ECB paper doesn’t propose any safeguards, merely saying that successive moratoria should “as a rule” be avoided.

The ECB states that the new moratorium tool is necessary to provide banking authorities time to determine if a bank must be put into resolution. They argue the bleeding obvious: that if guaranteed deposits are not included in the moratorium, depositors would rush to withdraw their funds to “ensure uninterrupted access”, believing a bank failure imminent. This would be “counterproductive”, said the ECB. No kidding, but it only confirms the insanity of bail-in, as it actually destroys confidence in banks.

Eyeing off Asia

A new report by ratings agency Moody’s, titled “Banks—Asia-Pacific, Asia’s bank resolution reforms show mixed progress”, reveals the urgency in the drive to finalise a cross-border bail-in framework in Asia before a new crisis hits, in order to protect global derivatives trades. “In most APAC [Asia Pacific, including Australia] jurisdictions, authorities still lack statutory powers to bail in creditors”, Moody’s moans in a 20 November press release announcing the report. “Basel III contractual securities [so-called “hybrid” or “contingent convertible” (coco) bonds which convert to worthless shares in the bank during a crisis] remain the only type of bail-in-able instruments in most markets”, and represent only some 2 per cent of bank assets in APAC banking systems. “Only Hong Kong and New Zealand authorities have the power to bail in depositors, and only unprotected depositors in the case of Hong Kong”, the release complains.

The solution: people before gambling debts

In the 2007-08 global financial crash, banks were bailed out to arrest the meltdown of the Too-Big-To-Fail (TBTF) banks’ US\$1.2 quadrillion (!) in derivatives bets. To pay for this bailout, governments borrowed massively and then imposed brutal austerity budget cuts which crushed their economies. Quantitative easing (central bank money-printing) reinflated the speculative bubble that caused the crash, while lending into the productive economy declined.

In response to public rage that the banks that caused the crisis were bailed out, international financial authorities unveiled their new “bail-in” scheme—supposedly to have the banks’ creditors foot the bill instead of taxpayers. Where bail-in has been used in Europe, “subordinate bondholders” who are the equivalent of depositors have lost their life-savings, while taxpayers have still had to bail out the banks anyway! Bail-in is not sufficient alone, because no amount of deposits can cover the losses from multi-trillion dollar derivatives bets. Moreover, bail-in actually preserves the very flaw it was claimed to fix—TBTF banks. The Bank of England specifies that some banks can be allowed to fail without affecting the wider economy, but others that are too large or complex would destabilise the system and must therefore be saved. Likewise says the ECB opinion paper in regard to derivatives: they are too complex so can’t be bailed in, unlike “long-term unsecured vanilla [sic] debt”—vanilla meaning your savings! Exemptions from the new ECB withdrawal moratorium would also apply to financial market infrastructure including central counterparties (CCPs—derivatives clearing houses) and the transfers of the Bank for International Settlements (BIS), which designed the bail-in regime.

Every new aspect of bail-in is in fact a powerful argument for the opposite approach to banking security: the Glass-Steagall separation of deposit-taking banks from speculation. Glass-Steagall protects deposits absolutely, and guarantees financial stability by separating essential banking functions that support the real economy from the casino economy.