Citizens Electoral Council of Australia

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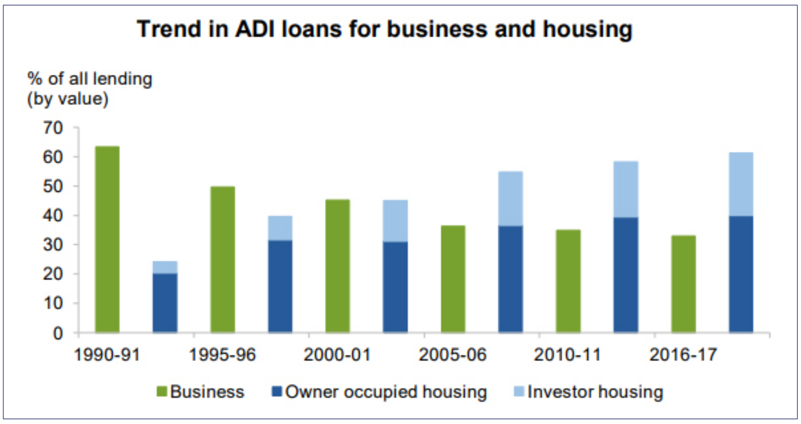
Banks are structured to exploit customers—the Royal Commission must investigate APRA and banking structure



This chart shows the dramatic reversal in bank lending priorities since 1990. Thousands of Australian small business owners and family farmers have suffered due to APRA encouraging the banks to prioritise mortgages above all else. Source: Productivity Commission..

When Malcolm Turnbull called the Banking Royal Commission, after receiving permission from the banks, he was jumping before he was pushed. On behalf of the banks, Turnbull and his fellow bankers in the Liberal Party were alarmed that National MPs had gone rogue with the ALP, Greens and crossbenchers, to draft terms of reference that would have required the Royal Commission to examine the structure of banking and the regulatory system. Among other things, this would have included bank regulator the Australian Prudential Regulation Authority (APRA), and so-called vertical integration—the practice of universal banking, in which major banks are massive conglomerates of all kinds of financial services. Turnbull's bank-approved terms of reference for the Royal Commission dropped any mention of vertical integration, and stipulated that the Royal Commission is "not required" to inquire into "macro-prudential policy and regulation", i.e. the regulatory structure of banking, including APRA's prudential policies.

This restriction is a travesty. It's akin to an inquiry into chicken deaths being disallowed from investigating the management of hen houses by foxes! The Commissioner can do the best job in the world, but if all he is allowed to do is investigate and highlight instances of banks abusing their customers, but not look into the structure of banking that allows banks to exploit their customers for their group profits, the Royal Commission is an exercise in futility. That is no reflection on Commissioner Kenneth Hayne.

Aside from financial greed, the two biggest contributors to the way Australia's banks have abused their customers on an industrial scale are their vertical integration, and APRA's prudential policies.

Vertical integration

A report from the Australian Securities and Investments Commission (ASIC) released 24 January confirmed that the vertically integrated structure of banks makes it easier for them to fleece their customers. The report, "Financial advice: Vertically integrated institutions and conflicts of interest", reviewed the financial advice provided by Australia's five biggest financial institutions: CBA, ANZ, NAB, Westpac and AMP. This has been a scandal-ridden sector of the financial system for more than a decade. The complicity of banks in such financial debacles as Storm Financial, the Timbercorp and Great Southern managed investment schemes, Opes Prime, and many others, has left thousands of Australian families ruined.

The report's findings were entirely predictable. Nearly 70 per cent of the funds that banks advised their customers to invest went into in-house products sold by the same bank. This was despite the fact that nearly 80 per cent of the investment products that bank staff were authorised to sell were from other institutions. In other words, bank staff had a clear bias in pushing their bank's products. Anyone who has queued at a bank simply to cash a cheque or such-like only to have the teller recommend insurance or some other product has experienced this bias. Bank customers have been sitting ducks for banks to lure into their other businesses, often with disastrous results—for the customer.

APRA's prudential rules

For more than a decade, Australia's banks have had a huge incentive to starve small businesses and family farms of credit, and to foreclose on thousands of those enterprises even when they weren't in default. This led to many of the cases of abuse that drove calls for the Royal Commission. APRA provided this incentive. It did so, by changing its prudential rules to make mortgages far more profitable than loans to productive business enterprises.

APRA's incentive came from its lowering of the "risk-weighting" of mortgages compared with other types of loans. Risk-weighting is a modern banking scam, that artificially lowers the requirement for how much capital banks put aside against their loans, to absorb potential losses. Historically it was assumed that the capital requirement applied to all loans, but in the mid-2000s APRA decided to assess different types of loans as having different levels of risk. The level of assessed risk was called the risk-weighting. APRA decided that home mortgages were far less risky than bank loans to businesses. Whereas business loans had a 100 per cent risk-weighting, meaning that capital had to be held against all such loans, APRA assessed mortgages only had a 50 per cent risk-weighting, so the banks only had to hold capital against half of their home loans. APRA then allowed the Big Four banks and Macquarie to assess their own risk-weighting, using secret internal risk models. The large banks eventually lowered the risk-weighting on their mortgages down to the ridiculous and self-serving level of 16 per cent. APRA supposedly tightened up on the big banks' mortgage risk-weighting in 2015, but they have only increased it to 25 per cent.

All of this made home loans far more profitable than all other types of lending, which incentivised the banks to do as much lending as possible for housing. It also motivated the banks to commit outright mortgage fraud in their pursuit of increasingly risky borrowers, including over-extended investors and "sub-prime" borrowers who couldn't afford repayments. When an internal APRA report warned in 2007 that the lower bank lending standards APRA had allowed had created a housing bubble and the risk of rising defaults which would cause a recession when it burst, APRA refused to publish the report.

The lowered risk-weightings also incentivised the banks to victimise business and family farm customers, for instance the Bankwest borrowers who were forced out of business by CBA when it took Bankwest over in 2008. In most cases, the Bankwest customers were still servicing their loans from profitable businesses, but CBA cited bogus revaluations to invoke covenants that allowed them to foreclose. All of the banks have repeated this dirty trick with small businesses and farms all over Australia. The money the banks have clawed back from their business lending in this way has been ploughed into more mortgages—thanks to APRA. The Productivity Commission's recent report on the banks highlighted that in the early 1990s, the big banks made two thirds of their loans to businesses and one third to housing, but now it is reversed, with two thirds for housing and one third for businesses. Consequently, Australia has a massive housing bubble that will collapse the Australian economy when it bursts, while the businesses and farms that produce the nation's wealth and provide our jobs are being starved of credit.

The Royal Commission must investigate APRA and banking structure. If the present terms of reference hinder such an investigation, the CEC calls on Commissioner Hayne to use his authority to insist the government expand the terms of reference to enable him to investigate APRA's policies and vertical integration. The government and banks must not get away with hobbling the work of this Royal Commission.

What you can do:

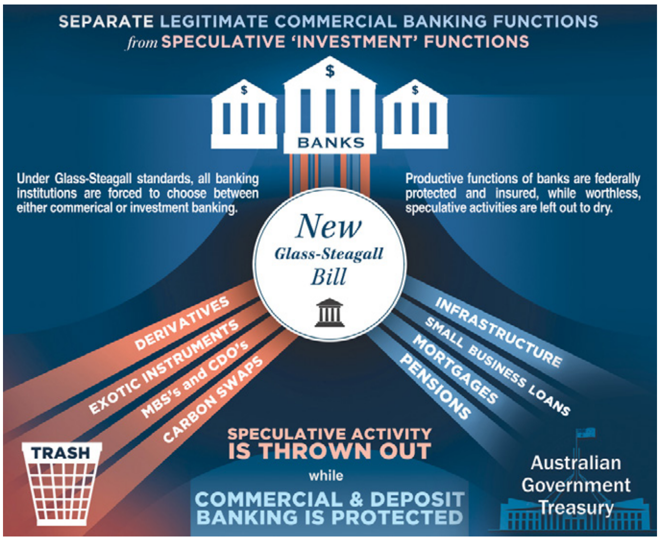
1. Email the Royal Commission on **FSRCenquiries@royalcommission.gov.au** to ask Commissioner Kenneth Hayne to expand his investigation to include the structure of banking (vertical integration) and the prudential policies of APRA.
2. Meet, phone or email your federal MP and Senators to demand they force the Turnbull government to expand the terms of reference for the royal commission, so it can properly investigate APRA's policies and the structure of banking, which have enabled the banks to exploit their customers and to get away with it.

Solution: Australia needs a Glass-Steagall banking separation

In 1933, the United States Senate conducted an inquiry into banking practices, led by New York prosecutor Ferdinand Pecora. It revealed similar abuses to what Australians have experienced in recent times. As a result of Pecora's inquiry, the USA enacted the Glass-Steagall Act 1933, which ended vertical integration by separating commercial banks with deposits, from investment banks, insurance companies, and all other financial services. The law was in place for 66 years, until Wall Street succeeded in getting it repealed in 1999. While Glass-Steagall was in place, there were no systemic banking crises in the USA; its repeal allowed banks to use deposits to underwrite an explosion of financial speculation which caused the global financial crisis just nine years later.

Australia needs Glass-Steagall to:

- protect deposits;
- end vertical integration, to protect depositors from predatory banks trying to lure them into other business;
- ensure deposits are only used for normal lending, which will keep more money in the real economy and available for banks to lend to productive enterprises;
- stop banks from securitising mortgages—meaning on-selling them to other banks to be bundled into risky derivatives—which will put a brake on mortgage fraud and excessive mortgage lending to risky borrowers.



The Citizens Electoral Council of Australia is leading the fight to get Glass-Steagall implemented in Australia. To do more than expose the crimes of the banks and maybe get some compensation, join the CEC's campaign for Glass-Steagall—to actually change the system that allows the banks to fleece, abuse and exploit their customers.