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Independent Political Party

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

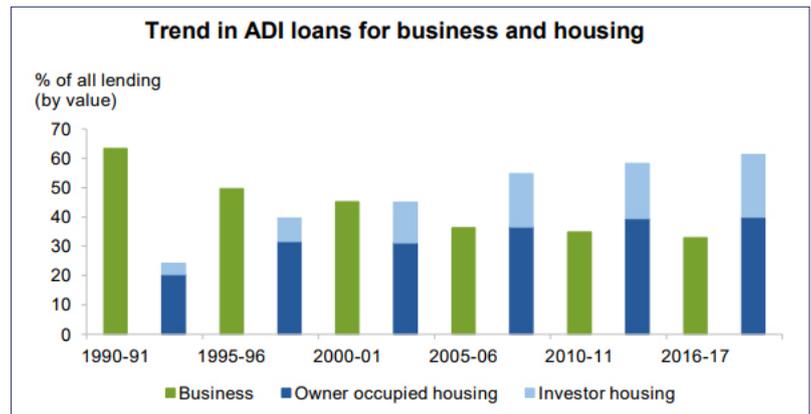
When Malcolm Turnbull called the Banking Royal Commission, after receiving permission from the banks, he was jumping before he was pushed. On behalf of the banks, Turnbull and his fellow bankers in the Liberal Party were alarmed that National MPs had gone rogue with the ALP, Greens and cross-benchers, 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 Fi-



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..

ancial, 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

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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.

The banks' greatest fear is the CEC's Glass-Steagall policy to break them up

The 13 March *Australian Financial Review* editorial (The *AFR* View) drew the battle lines in the fight over banking in Australia. On one side are the big banks, their apologists in Parliament and the media, like *AFR*, and their accomplices in APRA and the other regulators. They claim the banking system is "successful" and "unquestionably strong", and opposed a Royal Commission, despite the plethora of evidence of bank crimes and abuses of customers. On the other side, according to the *AFR*, is the Citizens Electoral Council. The *AFR* didn't single out the CEC by name, but by its number one policy—the Glass-Steagall separation of the banks.

Speaking as it does for the banks, the *AFR* revealed that, more than having the banks' crimes and abuses aired in the Royal Commission and being forced to compensate their victims, the banking establishment's greatest fear is they will be forced to break up. This is clear from the stern warning the *AFR* editors issued to Commissioner Kenneth Hayne. "The Hayne commission is not designed to be an inquiry into how our entire successful banking industry has been structured", *AFR* said, "and nor must it become one." (Emphasis added.) The editorial expressed the fear



The CEC's Queensland State Secretary Jan Pukallus outside the first day of hearings of the Banking Royal Commission on 13 March, delivering the CEC's message that the banks fear most: investigate APRA and banking structure.

that the magnitude of the inquiry "sets up the expectation that some radical overhaul of the banking system should follow" such as "a forced break-up of their activities", specifically the "vertical integration of banking, insurance and wealth management".

Of course, the CEC is not alone against the banks. On our side is most of the rest of Australia, all victims of the current banking system. Beside the thousands of small business owners, family farmers, and small investors whom the banks have financially ruined, everyone in Australia is a victim of the economic hardships the banks have caused: unaffordable housing and a property bubble that will bankrupt the country when it bursts; productive industries starved of credit; a record debt burden that has driven up the cost of living; poor and congested infrastructure, due to bank scams such as Public-Private Partnerships that exploit infrastructure for profit; and so on. The unbridled speculation of the banks has left every Australian at the mercy of a major financial crash. On 11 March the Bank for International Settlements warned that three

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of four key indicators in the Australian financial system—debt-service ratio, household debt service ratio and cross-border claims (overseas obligations, which includes derivatives)—are coded amber, indicating a looming crash.

Where the CEC is unique in opposing the banks, is in our single-minded focus on the structure of the banking system and the need for Glass-Steagall. Instead of getting mired in the myriad cases of banking misconduct and criminality, the CEC zeroed in on the structure that allowed those crimes to occur, and the solution to change it. Glass-Steagall is more than a regulation, it's a principle: the principle that the productive real economy which sustains the population must be protected from the predators and gamblers who would loot and destroy it for short-

term, paper profit, leaving bodies in their wake. The leading banker mouthpiece in Australia has now confirmed that a Glass-Steagall separation is the greatest threat to their system. This is a lesson for the banking victims who are fighting to see justice through the Royal Commission—to not just settle for compensation or an apology from the banks, but to fight with the CEC to overhaul the banking system so that banks can't prey on customers, and they are forced to serve the credit needs of the real economy.

The next stage of this fight is pressuring the government to expand the terms of reference of the Royal Commission, so it can investigate APRA and banking structure, and getting a Glass-Steagall bill introduced into Parliament, i.e. bring the banks' worst nightmare to life.

Top reasons the Banking Royal Commission must investigate APRA

The terms of reference that Malcolm Turnbull gave to the Banking Royal Commission only allow it to examine specific failings of regulators in relation to banking misconduct. It is not allowed to examine "macro-prudential policy", which is the regulatory structure of the financial system, and the policies of the Australian Prudential Regulation Authority (APRA), the bank regulator. Issued with the approval of the banks and regulators, Turnbull's terms of reference are clearly intended to hobble the Royal Commission and protect the banks. Here are the top reasons why Australians should demand that the Royal Commission be allowed to investigate APRA and the regulatory structure of the banking system.

1. APRA is the supervisor of the banks, and their atrocious abuses occurred under its supervision. Numerous experts and bank victims who have interacted with APRA accuse it of protecting the banks, not policing them.

2. APRA is a major cause of the rampant mortgage control fraud which the Royal Commission is investigating. APRA manipulated its prudential standards—the rules banks must follow—to make mortgages far more profitable than other lending. This encouraged the banks to lure as many people as possible into mortgages, not just to buy homes to live in, but also to buy multiple investment properties and to invest in the stock market. Many of the borrowers couldn't afford these loans, so banks forged documents to overstate their incomes and understate their living expenses to justify the loans anyway. The Royal Commission is investigating this fraud, but the investigation is incomplete unless APRA's role is also examined.

3. APRA looked the other way as banks lowered lending standards and committed fraud. In 2007 APRA chairman John Laker suppressed an internal report which showed that lowered lending standards, approved by APRA a few years earlier, had resulted in a bubble of more than three times the amount of lending for mortgages than would have been the case under the previous, higher standards. The report warned the delinquency rate could rise to 7.5 per cent, and trigger a housing market crash that would plunge Australia into recession. Instead of acting on the report, APRA buried it, encouraged even more reckless mortgage lending that further expanded the housing bubble, and ignored the mounting evidence of mortgage control fraud. The suppressed internal APRA report was only revealed nine years later in January 2016, by ABC reporter Stephen Long. Current APRA chairman Wayne Byres said in 1 March 2018 testimony to the Senate



Economics Legislation Committee that APRA hasn't really examined mortgage fraud, and has found no evidence of illegal activity by banks.

4. APRA supervised the Commonwealth Bank as it committed numerous abuses and crimes, and is now attempting to cover up those crimes. The three-person panel APRA appointed last year to inquire into CBA's "culture", following allegations of large-scale drug- and terrorism-related money laundering, is headed up by long-time APRA chairman John Laker, on whose watch in 2003-14 CBA got away with a litany of crimes and abuses—i.e. Laker is effectively investigating himself. Current APRA chairman Wayne Byres admitted to a parliamentary committee hearing on 13 September 2017 that the purpose of APRA's inquiry was to help CBA restore community trust and its badly damaged "reputation", with no mention of holding CBA to account.

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5. APRA abuses its extreme secrecy restrictions to suppress important information about its policies, and the banking system. APRA's secrecy restrictions are only intended to protect the private account information of bank customers, but APRA has weaponised these restrictions to keep its employees ignorant about its activities outside of their own departments, and to keep information from the public, such as the 2007 report on the consequences of lowered lending standards, cited above.

6. While formally an Australian government authority, APRA actually operates as an agency for the supranational financial regulation apparatus centred in the Bank for International Settlements (BIS) headquartered in Basel, Switzerland. Known as the "central bank of central banks", the BIS enforces a neoliberal ideology of financial self-regulation that constrains governments more than banks, and enabled the banks to rush headlong into the extreme financial speculation and derivatives gambling that snowballed into the global financial crisis in 2008. Current APRA chairman Wayne Byres was the chair of the Secretariat of the BIS's Basel Committee on Banking Supervision in 2012 when it issued its "Core Principles for Effective Banking Supervision", which demanded that there must be "no government or industry interference that compromises the operational independence of the supervisor", i.e. supervisors like APRA must be a law unto themselves.

7. APRA is covering up its "bail-in" agenda, which is to use the savings of Australians to prop up banks that fail as a result of the reckless financial gambling that APRA allows them to engage in. In his 1 March Senate Estimates testimony, Wayne Byres denied APRA has bail-in powers, yet APRA lobbied for the recent *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*, which allows it to forcibly convert or write off bank hybrid securities, in which Australian mums and dads have invested \$43 billion of savings, or "any other instruments", which is wording that is deliberately broad so as not to exclude bank deposits. This law is drawn from the BIS-based Financial Stability Board's "Key Attributes of Effective Resolution Regimes", which includes "bail-in" of "unsecured, uninsured creditors", meaning depositors. Australian authorities started planning for bail-in powers as early as the 2010-11 financial year, when Treasury paid for legal advice on bail-in powers. In September 2012 Treasury issued a discussion paper on measures for "Strengthening APRA's Crisis Management Powers", which included bail-in; in November 2012 the IMF noted that Australia is "exploring bail-in options"; and in April 2013 the FSB reported that "bail-in ... legislation is in train in some jurisdictions ... including Australia"—the crisis resolution powers law passed in February is the bail-in legislation to which the FSB referred.

What you can do:

1. 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.

2. 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.

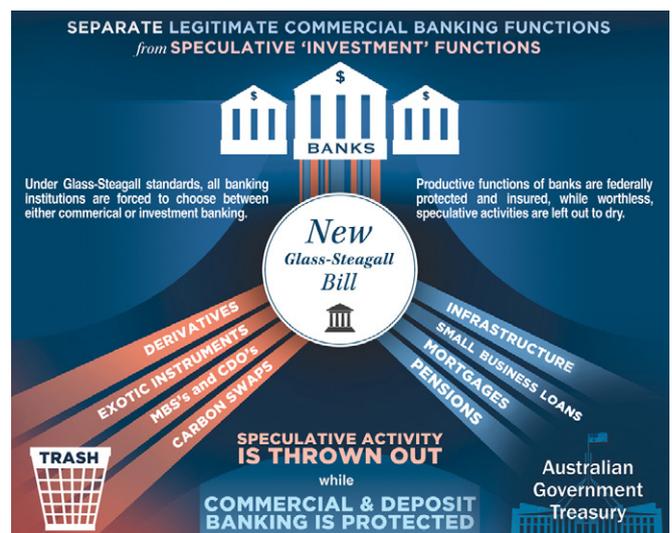
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Solution: Australia needs a Glass-Steagall banking separation

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 fleec, abuse and exploit their customers.