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MY REF: CEC:RHB

YOUR REF:

8 July 2019

Mr R Barwick,
Citizens Electoral Council of Australia,
595 Sydney Road,
COBURG VIC 3058

Dear Sir,

RE: BANK DEPOSIT ACCOUNTS - TERMS AND CONDITIONS
BAIL-IN PROVISIONS

Further to my previous opinion in relation to the ***Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018*** ("the Act") and bail-in by Australia's banks of customers' deposits, I have been asked to consider the provisions of the new Terms & Conditions being introduced by banks operating in Australia in respect of their deposit accounts.

Most such Australian banks have recently changed their Terms & Conditions relating to deposit accounts, many with effect as from 1 July 2019. Such changes have apparently been brought about by the Banking Code of Practice 2019 and arguably the Banking Royal Commission Report (which itself resulted in the changes to the Code).

The Banks have not adopted identical wording; rather, their changes are reflective of the individual Bank's approaches.

I will at this stage concentrate on the changes made by HSBC Australia whose changes highlight the issues of concern surrounding bail-in. HSBC Bank Australia Limited is part of the worldwide HSBC Group and is an Authorised Deposit-taking Institution ("ADI") as defined in the *Banking Act 1959*, having been granted a banking licence in 1986.

Bail-in insofar as it relates to deposit accounts is one of the actions which can be taken in respect of a distressed bank. Bail-in is the injection into the bank of the necessary capital to meet the bank's liabilities either by the bank writing off its liabilities to creditors or depositors or converting creditors' loans or deposits into shares whereby creditors and depositors take a loss on their holdings. A bail-in is the opposite of a bail-out which involves the rescue of a financial institution by external parties, typically governments that use taxpayers' money.

"*What does bail-in do? Bail-in allows a bank to be re-capitalized, with shareholders wiped out or diluted, and creditors will have their claims reduced or converted to shares. As part of that framework, there will be a predefined order in terms of the seniority of claims, in order for the institution to regain viability.*" - Chantal Hughes, spokeswoman for Michel Barnier, the European Commissioner for Internal Market and Services, 2012

As advised in my earlier Opinion, I am of the opinion that the provisions of the Act do provide for a power of bail-in of bank deposits which did not exist prior to the passing of the Act.

In addition to the issue as to the power of bail-in introduced by the Act, there is the further issue in relation to the implementation of bail-in of deposits revolving around the terms of the documents/instruments issued by banks in opening accounts and accepting deposits from customers.

The documentation issued by each Australian bank when opening such an account, contains a provision which enables the Bank to change the terms and conditions from time to time without the consent of the customer. The specifics of the power vary from bank to bank but each fundamentally contain such a power.

If APRA as the Prudential Regulator issued a Prudential Requirement Regulation or a Prudential Standard requiring a bank to insert a provision into its deposit-taking account documentation/instruments to provide for the bail-in of those deposits - their write-off or conversion - then that provision would then clearly bring the documentation/instruments within the specific conversion or write-off provisions of the Act and the deposit the subject of the account could be bailed in immediately.

Such a directive could be issued by APRA in accordance with the secrecy provisions in the *Australian Prudential Regulation Authority Act 1998* and be implemented with little or no notice to the account holder.

The changes to HSBC's Terms & Conditions so closely follow the consequences of a bail-in of customers' deposits that they seem to anticipate such a scenario and seek to prevent a customer from taking any action against HSBC to recover or claim compensation for the customer's resulting losses.

The relevant clause in HSBC's Terms & Conditions is 10.7.

Prior to its 1 July 2019 changes, that clause read as follows:-

"*10.7 We shall not be liable to you in tort (including negligence), breach of contract, breach of statutory duty or otherwise due to, under and/or arising out of or in connection with these Terms and Conditions to the extent such loss or damage is consequential, indirect, special or punitive, whether or not you had been advised of the likelihood of any such loss or damage.*"

In its 1 July 2019 amended Terms & Conditions and in its Product Disclosure Statement, that clause now reads as follows:-

"*10.7 Both you and we will not be liable to each other for any of the following losses or damages (whether you or we knew or could foresee any of these losses or damages):*

a) loss of revenue;
b) loss of actual or anticipated profits;
c) loss of the use of money;
d) loss of anticipated savings;
e) loss of business;
f) loss of opportunity;
g) loss of goodwill;
h) loss of reputation; or
i) any indirect, consequential or tortious loss or damage however caused"

Whilst the new provision seeks to provide for mutual exemptions from liability, it is difficult to see how a Bank could have claims against one of its customers for the losses referred to. The provision is clearly directed towards exempting the bank from liability for claims made

by a customer for losses incurred through the events referred to, and is not limited to losses in tort or breaches by the Bank (as was previously the case).

Each of the losses listed in the clause would follow if the Bank was to bail in that customer's deposit accounts, although some would only follow if the customer was involved in conducting a business.

It is informative in considering those listed losses to consider the events which are considered as the "Template" for bail-in and have become synonymous with "bail-in," the notorious policy of writing off or converting bank deposits into shares to salvage the distressed or failing banking system, and that is Cyprus in 2013.

This opinion is not the place to discuss the history of those Cyprus events, but in summary: Cyrus joined the European Union in 2004 and the Eurozone in 2008 and adopted the Euro. On 16 March 2013 the Government announced the terms of a bail-out/bail-in agreement determined by the Troika (the European Central Bank, the European Commission, and the International Monetary Fund) and declared a bank holiday. The policy was rejected by the Cyprus Parliament and the bank holiday was extended until 26 March 2013. On 24 March 2013 cash withdrawal limits of €100 were imposed onaccounts for the largest banks in Cyrus. On 25 March 2013 a bail-in agreement determined by the Troika was implemented by which those depositors with over €100,000 either lost 40% of their money (Bank of Cyprus) or lost 60% (Laiki Bank) and what did remain could only be withdrawn at the rate of €300 per day (including withdrawals by businesses), with the result that all transactions thereafter could effectively only be undertaken in cash. The process had not been gradual. It was sudden and it was total: once it began in earnest, the banks were closed and depositors couldn't get their money out, then the bail-in regime was imposed.

For an individual, that process would involve at least, on the part of that individual (from the HSBC list of losses):

- *c) loss of the use of money;*
- *d) loss of anticipated savings;*
- *i) any indirect, consequential or tortious loss or damage however caused.*

For a business, that process could well involve on the part of that business, every one of the losses referred to in the HSBC list.

The Troika is not in a position to impose such a regime on Australian banks, but under the provisions of the Act, APRA is.

At a minimum, the Act empowers APRA to bail in so-called Hybrid Securities - special high-interest bonds evidenced by instruments which by their terms can be written off or converted into potentially worthless shares in a crisis.

However, the Act also includes write-off and conversion powers in respect of "*any other instrument*". The Government has contended that these words do not extend to deposits, on the basis that the power only applies to instruments that have conversion or write-off provisions in their terms, which deposit accounts do not. However, the reference to *"any other instrument*" would be unnecessary if the power only applied to instruments with conversion or write-off provisions; moreover, banks are able to change the terms and conditions of deposit accounts at any time and for any reason, including on directions from APRA to insert conversion or write-off provisions, which would thereby bring them within the specific terms of the write-off or conversion provisions of the Act.

My earlier opinion dealt with the meaning of "*any other instrument*" and whether that phrase

extends to the contractual documents creating a deposit account with a bank.

Section 11AF of the Banking Act provides that APRA can determine Prudential Standards which are binding on all ADIs. These standards are in effect regulations which have the force of legislation by virtue of the authorisation in the Banking Act. That power then leads into the issue of APRA using this authority to expand the meaning of "*capital*" the subject of conversion or write-off, to encompass deposits if deposits are not already covered by the reference to "*any other instrument*".

APRA has already adopted the need for certain capital to be capable of conversion or write-off, regardless of laws, constitutions or contracts which may affect such decisions, (see the Explanatory Statement for Banking (Prudential Standard) Determination No. 1 of 2014) as quoted in my earlier opinion.

The changes implemented by HSBC to its Terms & Conditions relating to Deposit Accounts would seem to be taking into account the effects of the implementation of a bail-in regime and to seek to prevent a customer from making a claim against the Bank for compensation for the losses as listed in clause 10.7 referred to above. Such a claim would undoubtedly follow if the bank sought to unilaterally include bail-in provisions into its documentation. Such a claim could also follow if it did so at the direction of APRA and there was any doubt as to APRA's power to give such a direction.

It is to be noted that bail-in applies to deposits in every other FSB jurisdiction in the world - including the USA, UK, EU, Canada and New Zealand.

Queensland LNP Senator Amanda Stoker, barrister, former prosecutor, judge's associate in both the Queensland Supreme Court and High Court of Australia, explained in a 5 November 2018 letter to a constituent: "*The legislation facilitates bail-in as a type of resolution power which is available for dealing with financial institution distress. This was done after the G20 leaders endorsed a new Financial Stability Board standard for Total Loss-absorbing Capacity. Specifically, it builds on the Key Attributes which specifies that Financial Stability Board jurisdictions should have in place legally enforceable mechanisms to implement a bail-in. The purpose of the Total Loss-absorbing Capacity standard ensures there are mechanisms in place to stop the 'domino effect' and reduce loss on [sic] bank shareholders, creditors and the Government.*"

The International Monetary Fund's February 2019 *Financial System Stability Assessment for Australia* seeks to put the intention of the Act beyond doubt and makes the intent clear. The IMF is demanding that Australia move beyond any uncertainty surrounding the "bail-in" scheme contained in the Act, and enact a full, unambiguous statutory bail-in regime that explicitly includes seizing deposits to prop up failing banks. The IMF Assessment provides that: "*More needs to be done to ensure that the authorities are well-positioned to resolve a systemically important bank or to address a systemic banking crisis*". That "*more*" is statutory bail-in powers, which means a law giving APRA power to bail in whatever is necessary to save a bank.

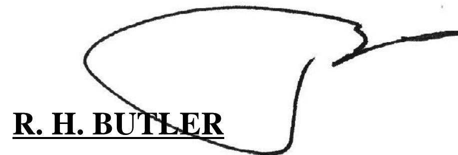
The IMF's Assessment takes the government at its word that the conversion and write-off provisions in the APRA crisis resolution powers in the Act may not extend to deposits: "*in the absence of provisions on statutory bail-in*", the IMF states in a footnote, "*such conversion and write-off provisions cannot be applied more broadly to other bank liabilities (excluding insured deposits).*"

In the context of statutory bail-in powers to bail-in deposits, the IMF demands changes to APRA, including clarification of APRA's responsibilities, which currently are stated as "*the*

protection of the depositors" of the banks and "*the promotion of financial system stability in Australia*", to reflect the fact that "*financial stability*" is the primary objective, ahead of depositor protection. It would appear that the provisions of the HSBC Terms & Conditions are anticipating that a bail-in regime may well be implemented and it is trying to position itself to be protected as far as it can from any liability for its implementation.

As advised in my previous opinion, whilst not beyond doubt, it is my opinion that the provisions of the Act do provide for a power of bail-in of bank deposits which did not exist prior to the passing of the Act and that banks, and specifically HSBC, are taking that prospect into account in re-drafting their Terms & Conditions.

Yours faithfully,



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