Why S&P is covering up ‘bail-in’

By Robert Barwick

The ratings agency Standard and Poor’s (S&P) has conspicuously and curiously denied that “bail-in” is in force in Australia. Bail-in is the policy of propping up failing banks with money confiscated from their “unsecured creditors”, including depositors; the Citizens Electoral Council has exposed that the Crisis Resolution Powers law snuck through Parliament in February 2018 includes a loophole that could allow the bail-in of deposits. However, S&P on 9 April issued a curious analysis that the Australian government would bail out distressed banks, rather than bail in their creditors. In response, the financial journal Banking Day on 10 April accused the “eccentric” CEC, as well as Digital Finance Analytics (DFA), which has also exposed the bail-in law, of spreading “claptrap”.

Since the Coalition government and Labor opposition conspired to enact crisis resolution powers for the bank regulator, the Australian Prudential Regulation Authority (APRA), there has been a concerted campaign to cover up the true nature of the law. The media mostly ignored it and the underhanded way it was passed—with only eight out of 76 senators present, no recorded vote, and while senators intending to amend the bill to explicitly exclude deposits were out of the chamber. The government, opposition, and bank regulator APRA all denied it was a bail-in law that applied to deposits. Meanwhile, the CEC, DFA’s Martin North and economist John Adams have continued to expose the law, and recruit public support to the fight to stop it. In October 2018 one Liberal Party politician, Senator Amanda Stoker, broke ranks and admitted it is a bail-in law.

S&P supports the bubble

S&P Global Ratings used tortured logic to justify its assessment that the Australian government would bail out, rather than bail in, failing banks. James Eyers reported in the 9 April *Australian Financial Review*: “S&P Global Ratings says there’s a one-in-three chance it will cut its assessment of government support of the major banks in a financial crisis, a move that would trigger a downgrade to their credit ratings and push up the cost of funding. “But for now, the international ratings agency says it believes both major political parties will ‘continue to hold a pragmatic view’ that a taxpayer-funded bailout of any major banks would be more likely to maintain financial system and economic stability than forcing losses onto bond holders.” Why did S&P hedge its bets on whether there would be taxpayer support of the banks? Because APRA is pushing Australia’s banks to increase their total loss-absorbing capacity (TLAC), which is part of the Bank for International Settlements-based Financial Stability Board’s requirement for banks to be able to be bailed in. TLAC is the total size of the financial buffer that banks maintain to absorb losses before going bankrupt, and includes equity capital (shares); so-called bail-in bonds a.k.a. hybrid securities that convert to shares; and unsecured, uninsured creditor claims, including deposits. APRA has asked the banks to sell an extra $75 billion in bail-in bonds, which the banks are complaining is difficult as investors are less likely to buy knowing the risks.

This means that S&P knows that Australia has bail-in measures in place; indeed, S&P foreshadowed that “we see some ambiguity in future policy direction on this matter”. However, despite all of these caveats, the ratings agency didn’t want to come out and say Australia has bail-in, because bail-in is supposed to be a substitute for bailouts. If Australia has bail-in, S&P would have to change its classification of the Australian government from “highly supportive” to just “supportive”, which would be saying that the government is less likely to provide financial support to a failing bank.

“The classification is important”, James Eyers explained, “because such a reduction in perceived supportiveness would trigger a cut to the credit ratings on all four of the major banks by one notch, to ‘A+’ from ‘AA-’. That would be likely to make it more expensive for banks to borrow from offshore investors who would build in a higher risk premium into bank bonds. That could increase interest rates across the economy, if banks passed those higher funding costs onto customers.”

And there you have it—if S&P officially acknowledged bail-in, it would have to downgrade the credit ratings of Australia’s banks which would push up interest rates. There’s no doubt that S&P, APRA, the Reserve Bank of Australia (RBA) and the banks all know that that would set off carnage in the already-plunging housing market. Already there are frantic calls for the RBA to cut interest rates further to save the bubble and the over-exposed banks, and signs that the RBA is preparing to do that. Right now Australia’s financial authorities are doing everything in their power to ensure there are no rate rises.

So the question is, would S&P give a fake credit rating to help support a speculative bubble? Of course it would, which was one of the causes of the 2008 global financial crisis. In a memorable scene in the movie *The Big Short*, S&P’s eye-shade-wearing representative justified giving banks triple-A ratings for worthless mortgage-backed securities: “If we don’t give them the ratings they’ll go to Moody’s, right down the block”, she whined.

It is therefore farcical that Ian Rogers of Banking Day would seize on this S&P analysis to attack the CEC and DFA for stating that Australia has bail-in. Rogers, a former *AFR* editor, wrote: “These facts have so far made no difference to the animated protests that the absolute opposite is the truth, that claim being a passionate belief of the eccentric campaigners from the Citizens Electoral Council—one often endorsed by their publicist at one banking industry blog [DFA]. In short, there is no bail-in power of any type provided for under Australian law….” This is patently false, but to admit otherwise would risk imploding the banking system.