

Dear members of the senate enquiry,

This submission is in relation to

Banking Amendment (Deposits) Bill 2020

https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/s1257_ems_766940af-489b-46df-a319-1d9d35a17e22/upload_pdf/20S05em.pdf

Summary

Amends the Banking Act 1959 to: provide that the conversion and write-off provisions do not extend to the bail-in of deposit accounts; and provide that nothing in the Act or other Commonwealth legislation gives the Australian Prudential Regulation Authority the power to implement, authorise or direct the implementation of bail-in of deposit accounts.

This Submission

In my submission I will focus on why there is a need to legislatively state that retail deposits with ADI's (Authorised Deposit-taking Institution) should be exempt from being used to financially stabilise failing ADI's.

This bill seeks to provide bank deposits protection in the same legislative way as the Fair Entitlements Guarantee (FEG) (<https://www.ag.gov.au/industrial-relations/fair-entitlements-guarantee-feg>) provides financial assistance to cover certain unpaid employment entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer.

It could be argued that in both instances people's monies are held by an organisation to which they should be legally entitled to regardless of the solvency. However only one currently is covered by legislation, the other is not.

Government Deposit Guarantee

It is commonly believed that should a bank fail the Government Deposit Guarantee (Financial Claims Scheme (FCS)) will protect deposits up to \$250 thousand Australian dollars (AUD).

What is less known with the FCS Guarantee is that

- A) Each bank and its subsidiaries are considered to be a single ADI
- B) There are two limits applied
 - 1) 20 billion dollars per ADI (Authorised Deposit-taking Institution).
(<https://www.rba.gov.au/publications/bulletin/2011/dec/5.html>)
 - 2) 250 thousand dollars per depositor.

Example - Westpac and its subsidiaries St.George, BankSA, and Bank of Melbourne are considered a single ADI.

This single ADI holds a single \$20 billion FCS Guarantee, which applies to the total combined deposits of Westpac, St.George, BankSA, and Bank of Melbourne.

Where a depositor holds multiple accounts across these banks, they would only enjoy protection of up to \$250 thousand in total and NOT \$250k for each bank. This is because all of these banks are treated as a single ADI and the single FCS limit would be applied accordingly.

Requirement to activate the FCS Guarantee

The FCS Guarantee clearly states that the FCS Guarantee applies to failed ADI's.

Retail Deposits are not specifically mentioned as exempt from being used to stabilise the ADI prior to collapse. Because of this, it has led to conjecture and speculation whether retail deposits are safe in the face of a bank collapse.

As I understand it the following are the sequence of events that would lead to the FCS Guarantee being enacted.

1. Bank starts to fail.
2. Bank uses all available regulatory capital requirements to avoid failure (possibly including the tier 1 & 2 capital holdings – (this can include retail deposits aka **bail-in**)
3. Bank fails (presumably after exhausting all capital at their disposal, at this point all, or most of the tier 1 & 2 capital holdings has gone).
4. Now that the bank has failed, Government FCS Guarantee is enacted.

The existing FCS Guarantee documentation does not explicitly state at what point in the process the deposits will be covered.

At the point of failure?

At the point prior to where the ADI uses all available means to stabilise itself financially?

This is an important distinction, as both points would result in different amounts being potentially returned to the retail depositor via the FCS guarantee.

Scenario where retail deposits would NOT be covered by the FCS Guarantee

For the FCS Guarantee to be enacted, an ADI must fail. But what happens if the ADI is successful in stabilising itself through the use of regulatory capital requirements as well as the tier 1 & 2 capital holdings to achieve this?

This would mean that the FCS Guarantee is not enacted and some of, or all of the regulatory capital requirements and tier 1 & 2 capital holdings have gone, potentially including retail deposits with no protection since there was no failure.

1. Bank starts to fail.
2. Bank uses all available regulatory capital requirements to avoid failure (possibly including the tier 1 & 2 capital holdings – (this can include retail deposits aka **bail-in**)
3. Bank stabilises (presumably after exhausting some of or all capital at their disposal, this would include tier 1 & 2 capital holdings).
4. Since the bank has not failed, the Government FCS Guarantee is NOT enacted.

There is no provision in the Government FCS Guarantee that covers this scenario.

In this scenario, some of, or all retail deposits would be lost.

At issue, is that nowhere in any documentation does it state that retail deposits will be covered prior to the point of ADI failure. Nor does any documentation indicate that retail deposits are protected or excluded from being used by the ADI along with other tier 1 capital holdings to stabilise the ADI.

ADI's exceeding the Deposit Guarantee ADI limit

Where the total amount of deposits exceed \$20 billion, it means that not every dollar is covered by the FCS Guarantee, regardless of the \$250 thousand depositor limit.

The international body that monitors and makes recommendations about the global financial system – the “Financial Stability Board” highlighted a potential issue in its paper titled “The peer review of Australia”

https://www.fsb.org/wp-content/uploads/r_110926b.pdf (page 23)

The limit of AU\$20 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.

Is there a possibility of a bank failure in Australia?

While it would be accurate to say it is unusual for an Australian bank to fail, there have been instances in history that this has happened and in more recent times almost happened.

During the Global Financial Crisis, both Westpac and the National Australia bank received emergency funds from the US Federal Reserve according to documents released by the central bank.

National Australia Bank borrowed USD\$4.5 billion from the US Federal Reserve between 6 November 2008 and 15 July 2009.

Westpac borrowed USD\$1.09 billion from the US Federal Reserve in January of 2008 and 2009.

Further to this, In Kevin Rudds’ book “The PM Years”, speaking with regards to the GFC he states:

"We were particularly worried about three Australian banks - two second tier, one first tier - as we developed a range of contingency plans to prevent the collapse."

So while bank failure in may be unusual, the above would indicate that bank failure in Australia is not impossible.

Possible Solution

Should a bank fail, there would be a very large amount of money at stake. In my opinion, there is an easy solution that could be implemented to mitigate much of this risk.

Currently there is no separation from high risk ‘investing’ by the banks and low risk with regards to the safety of customer’s deposits. In the current system, the risk/reward system does not exist.

Having a tiered system would allow depositors to select the risk profile of their choosing that would be commensurate with the return on the investment, rather than the current single risk profile that exists across all accounts regardless of interest rates.

With this tiered system, the depositor could select a high risk/ high return account leaving the depositor more exposed to losses but also enjoying a higher rate of return on their money. Conversely, depositors who prefer safety over return could select a safer option, having deposits quarantined from any high risk investment by the bank.

This would allow the depositors to take charge of their finances through selection of appropriate risk profiles for their situation, much like the risk profiles currently offered by the Superannuation industry.

The government could align the protection guarantee with the account risk profiles, via lower protection for high risk and higher protection for low risk profiles.

Of course, for this tiered system to work, the banks would need to be open and transparent in what they are investing in, including the investment weighting, just like the Superannuation Industry does.

Conclusion

Should a bank failure occur, it would undoubtedly have tremendous impact. Should retail depositors lose their money during a bank failure, it would be devastating to people's lives, the Australian economy, trust in banks and the political system who undoubtedly would be seen as failing to protect the Australian citizens through legislation.

In passing this bill, it would in effect

- Quarantine retail deposits preventing them from being used by the ADI, thus avoiding potential losses to the community.
- Remove the reason for bank runs by the public, which could inadvertently push a bank into insolvency
- Almost eliminate the need for the Federal Government's Financial Claims Scheme.
- Limiting the fall out of the failed bank upon the Australian economy.
- Ensuring public faith in Australia strong economy and governments continues.

In closing, I implore you to pass the **Banking Amendment (Deposits) Bill 2020**, to give both certainty and peace of mind to all Australians with deposits in Australian Banks.

I would also like to take this opportunity to thank you for your time and for giving me the ability to show my support for this bill.

Yours sincerely

