Senate Economics Legislation Committee
Parliament House
Canberra.

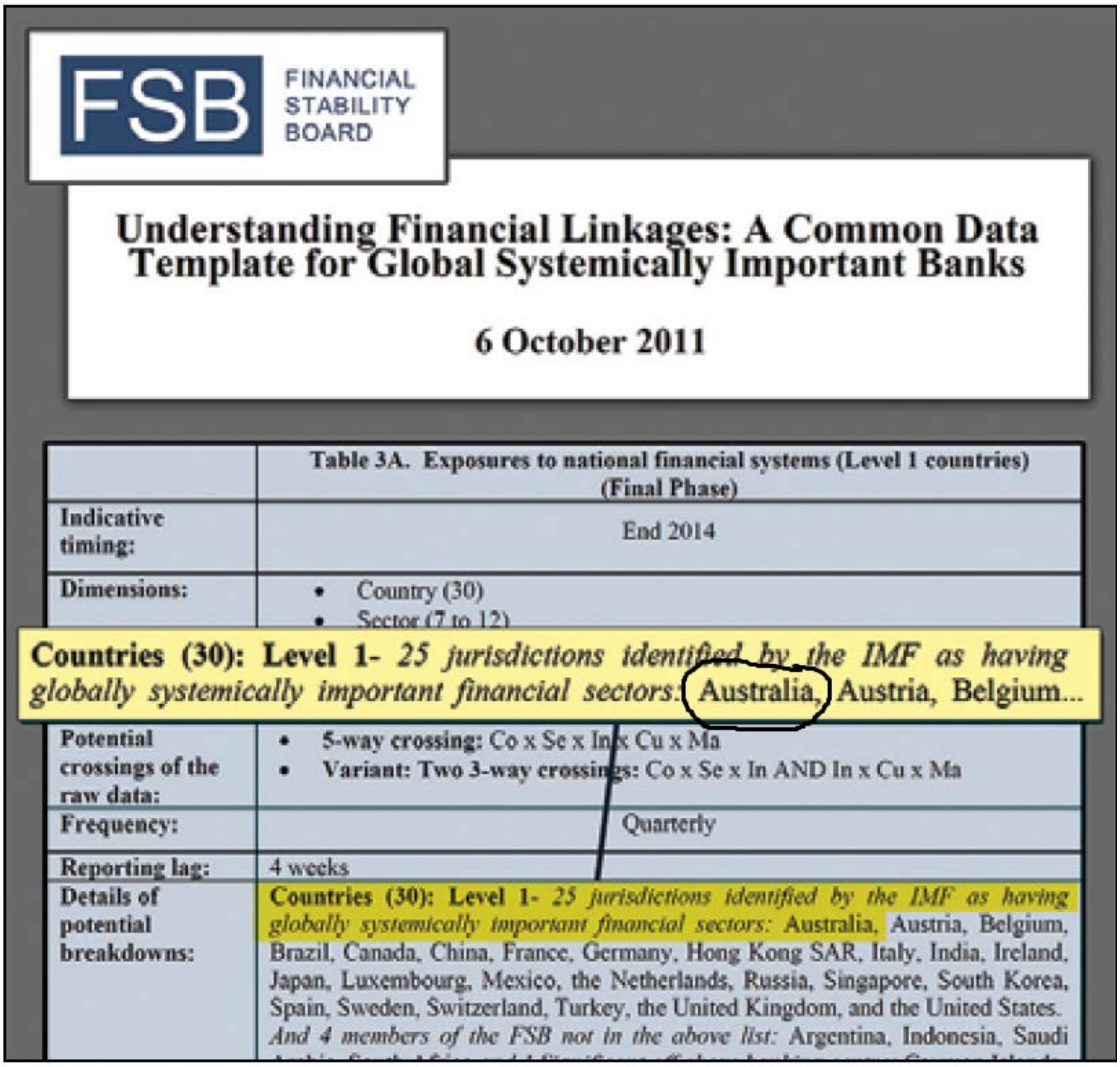
Personal submission on the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017

Dear Senators,

Thank you for providing the opportunity for members of the public to have some say on the ***Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017*** (Crisis Resolution Powers Bill).

I have been following developments of Australia's banking rules since reading about the Financial Stability Board's plan from 2011 to introduce the "bail-in" model bank resolution to Australia.

In 2011, the international Financial Stability Board (FSB) listed Australia's financial sector as "globally systemically important". This declaration was the first clear evidence that Australia was targeted for the bail-in – the method promoted by the FSB for resolving a distressed bank. See image below.



FSB FINANCIAL STABILITY BOARD

Understanding Financial Linkages: A Common Data Template for Global Systemically Important Banks

6 October 2011

Countries (30): Level 1- *25 jurisdictions identified by the IMF as having globally systemically important financial sectors:* Australia, Austria, Belgium...

	Table 3A. Exposures to national financial systems (Level 1 countries) (Final Phase)
Indicative timing:	End 2014
Dimensions:	• Country (30) • Sector (7 to 12)
Potential crossings of the raw data:	• **5-way crossing:** Co x Se x In x Cu x Ma • **Variant: Two 3-way crossings:** Co x Se x In AND In x Cu x Ma
Frequency:	Quarterly
Reporting lag:	4 weeks
Details of potential breakdowns:	**Countries (30): Level 1-** *25 jurisdictions identified by the IMF as having globally systemically important financial sectors:* Australia, Austria, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, Italy, India, Ireland, Japan, Luxembourg, Mexico, the Netherlands, Russia, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. *And 4 members of the FSB not in the above list:* Argentina, Indonesia, Saudi

That Australia was considering adopting the bail-in (Open Bank Resolution) law was evident from the Treasury Annual Report of 2010-2011 when the Commonwealth Treasury commissioned the Australian Government Solicitor to provide advice on the bail-in mechanism in Australia. See image below.

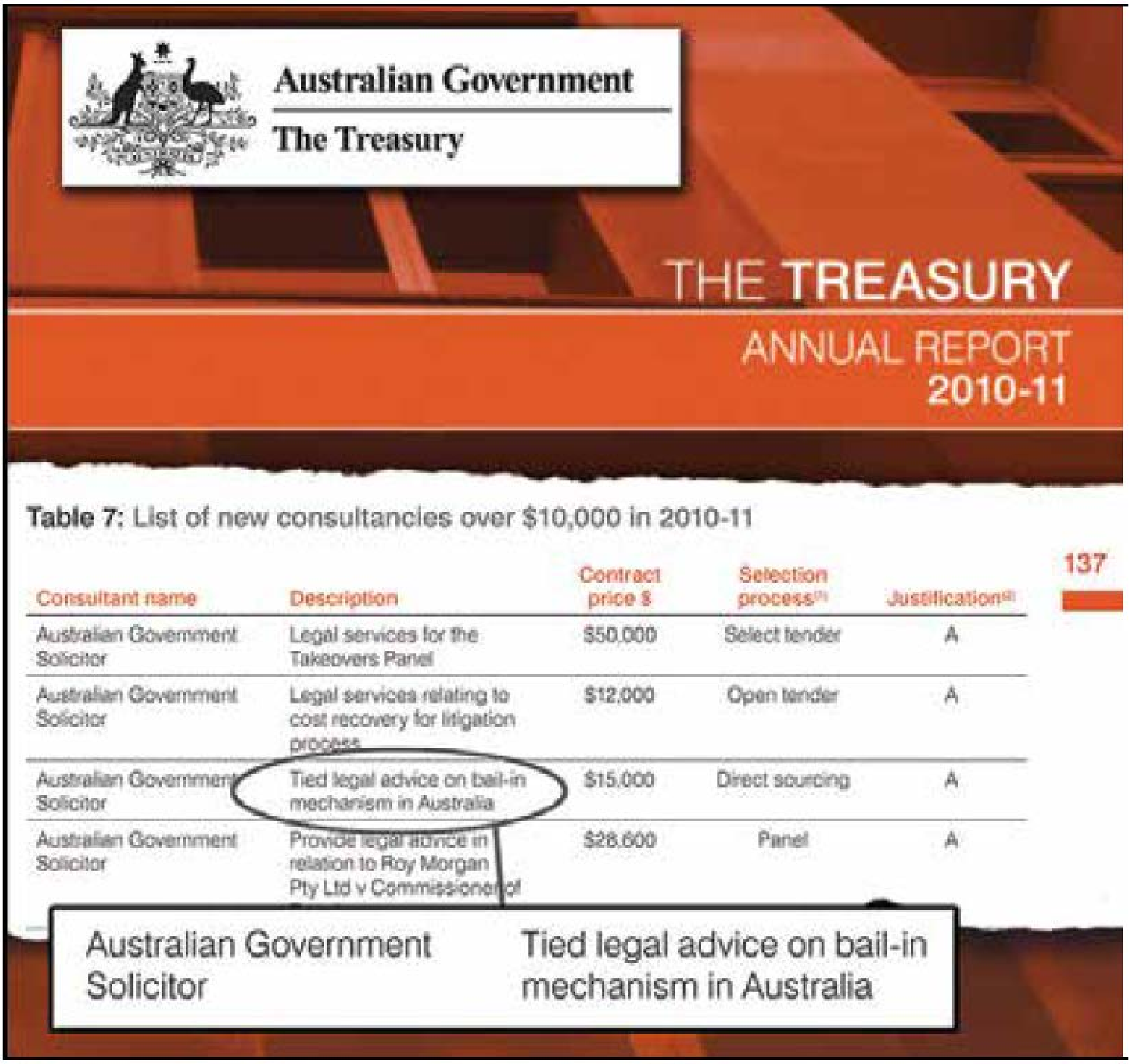


Table 7: List of new consultancies over $10,000 in 2010-11

Consultant name	Description	Contract price $	Selection process[1]	Justification[2]
Australian Government Solicitor	Legal services for the Takeovers Panel	$50,000	Select tender	A
Australian Government Solicitor	Legal services relating to cost recovery for litigation process	$12,000	Open tender	A
Australian Government Solicitor	Tied legal advice on bail-in mechanism in Australia	$15,000	Direct sourcing	A
Australian Government Solicitor	Provide legal advice in relation to Roy Morgan Pty Ltd v Commissioner of	$28,600	Panel	A

The September 2012 Treasury discussion paper ***Strengthening APRA's Crisis Management Powers*** called for the Australian Prudential Regulation Authority (APRA), to be given extra powers to deal with a banking crisis — including "bail-in" powers.

This is evident from the statement taken from Page 5 of the ***Strengthening APRA's Crisis Management Powers*** document. See image below.

In this context, the FSB's Key Attributes set out the types of resolution powers that jurisdictions should have available for dealing with financial institution distress. These include the need for robust statutory powers to:

- issue binding directions to ADIs, general insurers and life insurers supervised by APRA (regulated entities), including the removal and replacement of directors and management;
- appoint an administrator to assume control of a regulated entity;
- implement resolution of distress in respect of financial groups, including holding companies and subsidiaries;
- implement resolution of distress in a branch of a foreign bank or insurer;
- transfer some or all of the business of an entity or group to another entity as part of a resolution process;
- override shareholder rights where required;
- establish a bridge institution;
- suspend or cancel financial obligations; and
- facilitate bail-in.

1 Available at: www.financialstabilityboard.org/publications/r_111104cc.pdf.

In November 2012, the International Monetary Fund (IMF) inspected Australia's financial system. The subsequent IMF report informed that bail-in was on the agenda. See image below.

VI. Crisis Management and Resolution of Systemically Important Banks

55. **The structure of the Australian banking sector calls into question whether extraordinary tools for resolving large ADIs may be necessary.**[51] The banking sector is highly concentrated and dominated by four ADIs, which together hold approximately 76 percent of total banking assets. The remainder of the banking sector comprises four mid-sized and a number of small Australian-owned ADIs, credit unions and building societies (representing approximately 8 percent of banking sector assets), foreign-owned banks (representing approximately 3 percent of banking sector assets), and branches of foreign banks (representing approximately 9 percent of banking sector assets). With respect to the large ADIs, ordinary liquidation proceedings could prove unmanageable due to their size and interconnectedness.

of their own failures. These two things should provide greater incentives for an ADI's

[51] Australia's crisis management framework includes such measures as bridge bank, recapitalization, merger, etc. and they are exploring bail-in options.

What is "bail-in"?

According to Investopedia, "bail-in" is:

> *… rescuing a financial institution on the brink of failure by making its 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 using taxpayers' money.*
>
> *Source: https://www.investopedia.com/terms/b/bailin.asp*

The very first bail-in was imposed on the people of Cypress in March 2011 when Laiki Bank and the Bank of Cypress became insolvent.

On March 22, 2011, parliament of the Republic of Cyprus had urgently approved new crisis management legislation that would enable the Central Bank of Cyprus to resolve insolvent institutions (*Resolution of Credit and Other Institutions Law of 2013*). Consequently, when a new bail-in plan was announced on March 25, it did not require further parliamentary approval.

The people of Cypress were therefore unaware that the new bank resolution law provided a legal basis to implement "bail-in". The failing Laiki Bank was immediately resolved with full contribution from shareholders, bondholders and uninsured depositors. Laiki Bank assets were amalgamated with the Bank of Cypress (BoC) and depositors' funds were converted to BoC shares.

Since the Cypress bail-in, the Financial Stability Board has been rolling out the bail-in model for Globally Systemically Important Banks (GSIBs). The bail-in procedure is referred to as "Open Bank Resolution".

When the New Zealand Government adopted the Open Bank Resolution procedures on January 1, 2012, deposits in New Zealand banks ceased to be protected by the Government.

> *Source: http://pubdocs.worldbank.org/en/120651482806846750/FinSAC-BRRD-and-Bail-In-CaseStudies.pdf*

A bail-in would, of course, be a surprise to the Australian public because bail-in legislation and the bail-in process depend on obfuscation and secrecy to be adopted by parliament. This is demonstrated by the current need for a Senate Committee to determine the actual effect on depositors' funds of the current Crisis Resolution Powers Bill.

Bail-in of depositors' savings would break the faith of depositors who believe that their money is safe in an Australian bank. A bail-in exercised by an Australian bank, in the current climate of resentment at the on-going and seemingly unpunished series of financial scandals, would elicit an angry response of unpredictable scale from the general public.

In his second reading speech to parliament, Mr Morrison did not allude to the bail-in provisions in the ***Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill***.

Instead, he made out that the bill merely fixed up some "technical issues". See below.

> *"This bill makes a number of technical amendments that ensure the machinery of government operates as intended during a resolution event. This includes technical enhancements to the operation of the Financial Claims Scheme and the efficacy of the legal framework for the conversion of capital instruments under the Basel III framework. These mechanical fixes will increase efficiency and certainty in the event of a crisis."*
>
> *Source: Hansard House of Representatives Thursday, 19 October 2017 P11274*

Of particular concern is Section 11CAA of the new Crisis Resolution Powers Bill which states that "conversion and write-off provisions" relate to

(a) Additional Tier 1 and Tier 2 capital; or
(b) ***any other instrument***.

That this bill introduces bail-in of Tier 1 (shareholders' equity) and Tier 2 (hybrid bonds) to the Australian Financial System is clear. The question that remains is whether bank depositors' funds are protected or not. In other words, could the term "any other instrument" in Section 11CAA of the bill refer to depositors' funds?

This is not explicitly stated in the bill. However, the wording is clouded by nebulous terminology such as "any other instrument" and the power being granted to APRA is so wide-ranging and secretive that perhaps it may **not** preclude the confiscation of depositors' funds.

This is a crucial issue that the Senate Committee must address.

The status of depositors' funds needs to be explicitly stated in the bill because this issue is of such personal importance to every Australian who has money deposited in a bank.

As the following observation notes, what the general public regards as "depositors", the banks regard as "unsecured creditors".

> *"The problem with the way the 'bail in' is being unleashed on the public is that most depositors in major banks don't see themselves as unsecured creditors to the bank. That's exactly what they are, though. Thus, it may not be clear to ordinary bank depositors that when 'bail in' legislation is adopted in your country, it means your savings could be confiscated to recapitalise a bank that's taken big losses on bad loans."*
>
> *Source: **How Bank Depositors Have Become Unsecured Creditors** by Dan Denning*
> ***Money Matters** July 11, 2014*
> *https://www.marketsandmoney.com.au/bank-depositors-unsecured-creditors/2014/07/11/*

Under the Financial Claims Scheme, deposits are ostensibly protected up to a limit of $250,000 for each account holder. However, the Crisis Resolution Powers Bill provides wide-ranging and secretive powers to APRA that allow for future changes to the prudential standards to expand the meaning of "capital" for conversion or write-off. See below.

> *"5.14 Presently, the provisions in the prudential standards that set these requirements are referred to as the 'loss absorption requirements' and requirements for 'loss absorption at the point of non-viability'. The concept of 'conversion and write-off provisions' is intended to refer to these, while also*

> ***leaving room for future changes to APRA's prudential standards, including changes that might refer to instruments that are not currently considered capital under the prudential standards****" (emphasis added).*

It is apparent that the world banking and finance system is striving to prepare for the next financial crisis. However, trying to protect the system from instability is not possible when the derivatives exposure of the banking and financial system is about twenty times Australia's Gross Domestic Product (GDP). The exposure is just too great and the risk of contagion from chains of counter-party obligations is not known as one counter-party default can lead to a cascade of other defaults.

> *Australia's big four banks have total exposure to $32 trillion in financial derivatives.*

Source: http://ausrealnews.com.au/2016/02/09/32-trillion-australian-banks-risky-exposure-to-derivatives-market/

The Gross Domestic Product (GDP) in Australia is about $1.7 trillion in 2017 yet Australia's big four banks have a total derivatives exposure of $32 trillion or nearly 20 times the nation's GDP.

Source: http://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/1345.0?opendocument?opendocument #from-banner=LN

Following the Global Financial Crisis, the RBA stated:

> *"The Australian financial system has coped better with the recent turmoil than many other financial systems."*

Source: https://www.rba.gov.au/publications/fsr/2008/sep/overview.html

However, NAB and Westpac secretly borrowed $US4.5 billion and $US1.09 billion respectively from the US Federal Reserve during 2008 and 2009. See below.

> *"… two Australian banks took advantage of the funding window opened by the Fed as the US bank tried stabilise financial markets ...*
>
> *NAB was the biggest user of the emergency facility among local banks, borrowing $US4.5 billion from the US central bank...*
>
> *… Westpac borrowed $US1 billion from the Fed, at the time pledging more than $US3.3 billion in collateral to back the loan…*
>
> *The Reserve Bank also made available billions of dollars of additional funds for local banks during the financial crisis. But it does not break out individual banks. During 2008-09 the Reserve's overnight lending averaged almost $4 billion a day, compared with about $750 million a day in the five years before the financial crisis.*

Source: http://www.smh.com.au/business/nab-westpac-tapped-fed-20101202-18i58.html

Perhaps our banks are not as secure as we have been led to believe.

Systemic risk in the banking and finance sectors has been encountered in the past. The Great Depression of the 1930s was resolved by separating the commercial banking functions from speculative investment banking as per the 1933 ***Glass-Steagall Banking Act*** in the United States which ushered in a period of 66 years of stable banking. Glass-Steagall was repealed in 1999 and, nine years later, the Global Financial Crisis occurred.

Separating commercial and investment banking provides a simple mechanism for protecting depositors' funds because commercial bank deposits are regulated and guaranteed but funding for speculative investment is not.

Under Glass-Steagall separation, banks are not unable to use depositors' funds to speculate so they must use their own funds and bear the full risk.

The argument that a bank is "too big to fail" is defeated and the moral hazard afforded by either bail-out or bail-in is removed.

With Glass-Steagall separation, Australia could rest assured that the risks and hazards of speculative investment banking are falling on the appropriate shoulders.

The *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017* is seeking to introduce "bail-in" to Australia by stealth and deception because the term "bail-in" is certainly not used at all in the text of the bill.

I hope the Senate Committee calls the government out on this and alerts the public to the implications of bail-in and promotes the alternative, proven solution of Glass-Steagall bank separation.

Yours sincerely,

[redacted]

Anthony Allison

Sunday, 26 November 2017