Australian Citizens Party

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MEDIA RELEASE

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Treasury forced to answer CEC and experts on bail-in bill

The government and regulators have been forced to answer objections raised in the flood of public submissions on the APRA "bail-in" bill. The Senate Economics Legislation Committee, which received more than 1,000 submissions to its inquiry into the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017, put a series of questions to the Treasury, Reserve Bank (RBA), Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments Commission (ASIC), based on the objections of the Citizens Electoral Council, former APRA principal researcher Dr Wilson Sy, and the Banking and Finance Consumers Support Association. The committee effectively asked Treasury and the regulators to prove that the bail-in powers in the bill can't be used to seize deposits. Despite their shrill denials, they couldn't.

To ensure the agencies didn't contradict each other, Treasury, being the government, coordinated the responses to the committee's questions; with a few exceptions, the regulators mostly referred to Treasury's answers. Only Treasury and the RBA addressed the question of deposits, yet neither could definitively guarantee that the legislation does not allow them to be bailed in.

Qualified denials

Treasury asserted that the CEC's and Dr Sy's warnings about deposits were "incorrect". When explaining the wording of the legislation, however, Treasury repeatedly qualified their denials with phrases such as "it is not the intention", "we do not believe", and "it cannot reasonably be interpreted", etc. This inability to be definitive backs up the CEC's point that the wording of the bill is broad enough to include deposits.

Treasury *was* definitive in asserting that the bill "does not include a statutory power for APRA to write down or convert the interests of other creditors in resolution, including depositors of a failing ADI (a so-called 'bail-in' power)". This disingenuous statement does not address APRA's powers already in the *Banking Act 1959* and which are re-enforced by the Bill. *Australian Financial Review* columnist Christopher Joye on 20 December 2015 wrote of APRA's existing bail-in powers: "The nub of the challenge for APRA is whether it is prepared to more publicly acknowledge that all bank-issued liabilities (except for deposits), including senior and subordinated bonds, can be forced to wear losses under Australia's laws." Nor does it address the statement in the Explanatory Memorandum that the bill leaves room "for future changes to APRA's prudential standards" that can redefine "other instruments" for bail-in, opening a back door to include deposits, which by definition are "instruments".

For its part the RBA emphasised its denial that deposits could be bailed in by going on the offensive, rightly declaring that "even small losses to deposit holders" could lead to "disruption", "contagion" and "financial instability"—essentially the same points the CEC has made. The difference is that the RBA doesn't mean what it says, because if it did, it is actually saying that the policies of the EU, UK, USA, and New Zealand, all of which have bail-in regimes that include deposits, could cause disruption, contagion and financial instability. That is true, and the CEC forcefully says so, but the RBA would not want to be on the record accusing Australia's partner jurisdictions of promoting financial instability.

The committee also asked the RBA to elaborate on the differences between Australia's approach and New Zealand's Open Bank Resolution (OBR), which forced the RBA to admit that in NZ deposits can be bailed in. The CEC had made the point in its original submission that given that New Zealand's OBR and the bail-in regimes of the UK, EU and USA all include deposits, Australians have grounds to be suspicious that bail-in authorities would eye off deposits here too.

Trans-Tasman bail-in?

As it happens, because NZ's major banks are all owned by Australia's Big Four banks, in 2010 Australia's Treasury, RBA, APRA and ASIC signed a Memorandum of Cooperation on Trans-Tasman Bank Distress Management with NZ's Treasury and Reserve Bank, in which both sides agreed to coordinate their actions to resolve banking crises which affect both countries. One paragraph of that agreement states:

"For systemically important banks, the participants will explore options for an open resolution of the parent and subsidiary banks that are most likely to be conducive to maintaining stability and

international confidence in the financial systems of both countries, and will advise their respective Governments accordingly.”

In New Zealand, “open resolution” means a bail-in of unsecured creditors, including depositors. The CEC’s concern is that the broad language of the APRA bill exposes Australian depositors to the same fate, especially in a banking emergency when financial authorities are scrambling to stop a bank failure that could set off a chain reaction here and around the world. Bail-in was conceived of for this very purpose. Two derivatives salesman who participated in the September 2008 emergency meeting held at the New York Federal Reserve to save Lehman Brothers, which was unsuccessful, hatched the idea that if there had been a system by which Lehman Brothers’ creditors could have been forced to wear its losses to avert its bankruptcy, that would have avoided the meltdown of its derivatives contracts that set off a chain reaction among the world’s banks. This idea of sacrificing customers of one bank to save the wider banking system was first applied to Cyprus in March 2013, when depositors were bailed in to stop the Cypriot banking crisis from triggering contagion across the EU.

In conclusion, Treasury and the regulators could only provide qualified, not definitive, assurance that the legislation does not include deposits, and they didn’t even try to address the section in the Explanatory Memorandum which foreshadows APRA being able to make determinations in the future that could include deposits for bail-in. The CEC has already exposed that APRA has existing bail-in powers, and the power to order a bank “not to repay any money on deposit or advance”—a short step from depositor bail-in. This bill minimally ensures that in a future banking crisis, there is nothing to stop APRA from extending its bail-in powers to deposits, if it is deemed necessary to avert a global financial meltdown.
