



Australian Citizens Party

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MEDIA RELEASE

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The Big Lie exposed! Australian financial system under APRA almost wiped out in 2008 GFC

The Big Lie of the Australian financial system is that it remained sound during the global financial crisis in 2008, due to the effective oversight of the Australian Prudential Regulation Authority (APRA). Treasurer Scott Morrison repeated this claim in his press release of 18 August 2017 announcing the government's new crisis resolution powers for APRA: "One of the key reasons Australia successfully navigated the Global Financial Crisis was the robust prudential regulation put in place by the Howard Government", Morrison said. Politicians cite the resilience of Australia's APRA-supervised financial system in 2008 to justify the sweeping new powers that the government is legislating for APRA to manage the next financial crisis. Former Prime Minister Kevin Rudd, however, has just exploded this lie.

[In a 25 November interview with Peter Hartcher](#) of the *Sydney Morning Herald*, Rudd revealed for the first time the truth that the US government bailed out the Australian financial system in 2008. Rudd effectively begged George W. Bush to bail out US insurance giant AIG, because it was the reinsurer for about a third of Australian insurance policies.

"If AIG had fallen over, the systemic shock to corporate Australia would have been devastating", Rudd said. "I said to George W. Bush, 'This is an alliance matter. *It goes to the fundamentals of what our economy needs to survive.* [Emphasis added.] I really need you to prevent AIG from going under.' I'm sure I wasn't the only voice on the matter, and God knows how significant the impact would have been for Asia and Europe too. But to George W. Bush's great credit he said, 'I hear you', and he did absolutely the right thing by us."

Hartcher noted: "This intervention has not been disclosed previously. The US government took control of the failing AIG at a cost of US\$180 billion." The AIG bailout was part of the US government's US\$700 billion Troubled Asset Relief Program (TARP) bailout; the US Federal Reserve has since provided more than US\$4 trillion in extra bailout funds, through quantitative easing (QE).

What prudential standards?

Rudd's story also reveals that far from APRA enforcing strong prudential standards, its standards were reckless, to say the least. Why had APRA allowed the insurers it supervised to have such a high concentration of reinsurance with just one company, and such a risky one at that? AIG had a massive exposure to toxic financial derivatives, especially to credit default swaps on worthless mortgages, which it had insured for Goldman Sachs. Yet under APRA's supervision a third of Australia's insurance contracts came to depend on this one basket-case company.

This wasn't the only area of the financial system where APRA's standards were shown up. APRA had allowed the banks to borrow heavily from overseas on very short terms—around \$440 billion in 90-day debt—to invest in long-term mortgage loans. This created a huge vulnerability, such that when inter-bank lending ground to a halt in September-October 2008, Australia's banks were unable to borrow to roll over this debt. The Big Four and Macquarie Bank were forced to literally beg Rudd for a guarantee that allowed them to borrow on the government's Triple-A credit rating in order to honour their short-term debt. A former Macquarie Bank executive told the CEC of total panic at the board level, as directors frantically tried to raise their government contacts on the phone. "I never thought I'd see Macquarie in favour of government intervention", he said, reflecting on the irony that Macquarie, which is a heavy funder of neoliberal think tanks that rail against government intervention in the markets, would suddenly want government welfare. Ross Garnaut and David Llewellyn-Smith recounted in *The Great Crash of 2008* that the banks warned Rudd that without the government's guarantee they would be "insolvent sooner rather than later".

Even more scandalous, APRA knew its prudential standards were garbage! A year before the GFC, [an internal APRA report](#) had revealed that due to Australia's banks lowering their lending standards, which APRA had allowed, the banks had expanded credit for mortgages 3.4 times more than they would have under their previous, higher standards. The report forecast that this bubble in the mortgage market would lead to delinquency rates of 7.5 per cent in the next three years—the same delinquency rate at which the US housing bubble started to burst in 2007—which would cause a recession. Instead of acting on it, *APRA's then chairman John Laker suppressed the report*.

The poor prudential policies exposed in this internal report weren't merely an error of managerial judgement. Under John Laker, APRA had deliberately adjusted its prudential levers to create the boom in home loans that caused the housing bubble. In the early 2000s APRA had lowered the capital risk-weighting for mortgages relative to other types of loans, to make mortgages far more profitable. This incentivised the banks to concentrate their lending on home loans, while starving the more productive small business and farm sectors of credit, and even withdrawing credit from those sectors through forced foreclosures—the kind of abuses that led to calls for a royal commission.

The politicians' support for APRA hinges upon this Big Lie that APRA's sound prudential standards kept Australia's banks safe during the GFC. The truth is Australia's financial system was propped up by two external actions: the USA's TARP bailout for AIG and the rest of Wall Street, some of which also flowed through to Australia's banks; and China's decision in early 2009 to launch a US\$1 trillion infrastructure spending program, which enabled Australia to resume the iron ore and coal exports on which the economy was completely dependent, and which had virtually ground to a halt.

Australia's elected MPs have been duped to believe that APRA is a sound regulator. They are being duped again to give APRA sweeping new powers to manage the next financial crisis (caused by the speculative practices that APRA hasn't just allowed, but encouraged), including powers to definitely "bail in" (convert to worthless shares, or write off) the savings of hundreds of thousands of self-funded retirees who own hybrid securities, and potentially bail in deposits. It is crucial that the APRA crisis resolution bill be defeated, and that Australia instead adopt a Glass-Steagall separation of deposit-taking banks from all other financial services—the only way to protect deposits and ensure financial stability.