Australian Citizens Party

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MEDIA RELEASE

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Murray inquiry sets stage for Australian bail-in law

The interim report of David Murray's Financial System Inquiry, released 15 July, pushes the case for supposedly solving the problem of too-big-to-fail (TBTF) by implementing "bail-in"—the system which includes confiscating customer deposits to prop up failing banks, Cyprus-style.

Furthermore, Murray recommends the Abbott-Hockey government continue the process commenced under the Gillard-Rudd-Swan governments, of aligning Australia's regulations with the Financial Stability Board's (FSB) Key Attributes of Effective Resolution Regimes, the financial measures to which G20 member countries are committed to comply, including bail-in.

Murray's interim report perpetuates the fraud that bail-in is a solution to TBTF banks, even though bail-in does nothing to reduce the size of the banks such that if they fail they won't damage the rest of the economy. Bail-in is presented as a way to ensure governments won't need to bail out a failing bank, because the cost will be borne by the bank's creditors instead.

(A bank fails when its losses are greater than its capital. In a normal bankruptcy, the bank's assets would be sold up and the proceeds distributed among its creditors, with depositors having a priority claim. In a bail-in, the TBTF bank is kept going, by forcing the creditors, including depositors which are "unsecured creditors", to take a drastic cut on what they are owed, sufficient to reduce the bank's liabilities below its assets, to pretend it is again solvent. In Cyprus in 2013, all depositors lost money, some more than 40 per cent of their total deposit.)

Murray effectively says that failing TBTF banks must be able to be resolved internally, so that there is no need for governments to bail them out. However, it cautions, this means that a bank's creditors (to whom it owes money) will have to accept losses, and the problem is that creditors are often other banks. If one bank's problems causes losses in other banks, it could trigger a wider banking crisis, which bankers call contagion. Therefore, Murray asks, which creditors are best able to absorb losses, in a way that doesn't risk financial instability?

This reasoning pushes the argument to one conclusion: shareholders and depositors.

The report highlights in blue the questions for further discussion: "Is it possible to reduce the perceptions of an implicit guarantee for systemic financial institutions by imposing losses on particular classes of creditors during a crisis, without causing greater systemic disruption? If so, *what types of creditors are most likely to be able to bear losses*?"

What is left unsaid in this argument, is that the specific area where defaulting banks are in danger of damaging other banks, is in their multi-trillion dollar derivatives gambling. When Lehman Brothers' bankruptcy in September 2008 caused it to default on its obligations to its derivatives counterparties in other banks, it blew a massive hole in the global derivatives bubble which triggered the global financial crisis that is still ongoing today. Murray is effectively making the case that a bank's derivatives gambling bets must be honoured above its depositors. (In the past 12 months, derivative gambling globally grew by 20 per cent, to around $2 quadrillion [thousand trillion] by some estimates, setting the world up for a new round of financial meltdown that will be worse than 2008.)

The interim report mentions bail-in four times, as a possible solution to TBTF. It also notes the gaps between Australia's current financial laws, and the FSB's "Key Attributes":

"The gaps identified include: powers to address a distressed foreign bank branch in Australia; the ability to require restructuring of a regulated entity to facilitate resolution; deficiencies in powers to resolve group distress; *a lack of statutory 'bail-in' powers to impose losses on particular creditors*…"

Murray explicitly recommends that the Hockey government continue the Gillard-Rudd-Swan government's process of working with the FSB to close the gaps, which can only mean one thing: finalise the legislation for bail-in powers that the FSB noted in its 15 April 2013 report was "in train in Australia".

Glass-Steagall

There is only one genuine solution to TBTF banks, which protects both the economy and bank deposits: a full, Glass-Steagall separation of investment banking from commercial banking, as mandated in America's 1933 *Glass-Steagall Act*. Under Glass-Steagall, the Big Four banks and Macquarie would be split up into completely separate new institutions: commercial banks that hold deposits and perform the so-called "boring", but safe, banking functions that service the community; and investment banks that engage in risky financial speculation. The two types of banking would have no contact whatsoever: no cross-ownership, no shared directors, no joint ventures. The commercial banks will be super-safe, and the investment banks will know that if their financial gambling goes bad, they are on their own, and will not be bailed out.

Murray's interim report noted that Glass-Steagall is an option, but argued the bankers' case, that a separation would be "expensive", to discourage any moves in that direction. A Glass-Steagall separation would indeed be expensive—to the financial gamblers who are currently able to gamble with depositors' funds, *not* to the depositors.