Citizens Electoral Council of Australia

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Independent Political Party

13 December 2017

APRA is the 'monster that protects the banks'

Major party politicians are putting the economic security of all Australians at serious risk by their misplaced confidence in the Australian Prudential Regulation Authority (APRA), the bank regulator. Labor MPs, for instance, are sending letters to constituents who are concerned about sweeping new crisis resolution powers for APRA, which express "confidence in the ability" of APRA to ensure the "stability and strength of the Australian financial system".

Yet the current Senate Economics Committee inquiry into APRA's new powers is drawing out experts and insiders who slam APRA for its extreme secrecy, its disregard of bank customers, its protection of the banks' myriad abuses, and its destructive distortion of the financial system.

One of these experts is Victorian businessman John Dahlsen, the former chairman of Woolworths and a director of the ANZ Bank for 20 years. In an August 2016 paper entitled "Banks—I See Things Differently", Mr Dahlsen wrote: "APRA is the monster that protects the banks from disaster and its constant interventions reduce competition."

Mr Dahlsen's paper is a no-holds-barred attack on Australia's banks and their regulator. "The inner world of banking is private, secretive, murky and dark and bank reputation and ranking is low", he describes, adding that it is an industry where there is a "a culture of vultures". He levels charges thick and fast, including:

* "Conflict is rife and often abused, and Chinese walls are illusory." * "Insider trading is subtle and obtuse and seldom reported." * "So long as banks collude and are all the same, the risk of concentration for Australia is acute. Only the Government can change that." * "APRA is not concerned with customers and competition because they are not in their remit." * "Banks trade in parallel and are all the same. You could change the labels and no one would notice. They defend their business walls from all intruders and nothing gets through because of APRA." * "Banks treat regulation as a game to protect their pay. They are more concerned about their rewards and their self-interest than the interests of customers and other stakeholders."

This is not a rural populist or a red-hot socialist speaking, it is a former director of one of the Big Four banks, and it is time that politicians took notice.

An insider's view

Former head of research and principal researcher at APRA Dr Wilson Sy has also been speaking out about the regulator he worked for in 2004-10. In his submission to the 2014 Financial System Inquiry, entitled "Implications of the Global Financial Crisis", Dr Sy accused APRA of secret dealings with the institutions it regulates, and for being asleep to the risks that led to the 2008 GFC.

"Secrecy was maintained in Australia during the GFC when Westpac and NAB came close to failure", he revealed, noting that only the flow-on of the US mega-bailout of Wall Street saved the Australian banks; APRA's secrecy "can create various types of corruption", Dr Sy warned. In the GFC, he said, APRA "failed to reject unsound credit risk models or to challenge them on their technical accuracy".

Following Prime Minister Malcolm Turnbull's 30 November announcement of a banking royal commission in which APRA would be excluded from scrutiny, Dr Sy fired off a letter to members of parliament. He warned them that the government's raft of impending APRA bills on "bail-in", superannuation governance and superannuation products "give APRA unwarranted powers to help the banks, more easily and legally, to plunder the wealth of ordinary Australians".

Dangerous ignorance

Most Australian politicians have never heard the views on APRA expressed by the likes of John Dahlsen and Wilson Sy. Their ignorance is dangerous, because they therefore don't question the Treasury's proposal to give APRA even more powers. Treasurer Scott Morrison played on this ignorance as he introduced the Financial Sector Legislation Amendment (Crisis Resolution Powers and other Measures) Bill 2017 into Parliament on 19 October, repeating the myth that APRA's "excellent supervision and robust capital requirements" were responsible for Australia's banks surviving the 2008 GFC. Unless politicians question those claims, they will end up voting for a bail-in regime that puts the Australian banking system under the control of the Bank for International Settlements (BIS) and its Financial Stability Board (FSB) in Switzerland. This control will be exercised through APRA, which the BIS insists the elected government must not interfere with. APRA will be empowered to impose even more extreme secrecy restrictions than it already does; to bail in hundreds of thousands of self-funded retirees and self-managed superannuation funds who have bought hybrid securities from the banks; and, given the broad language of the bill, possibly to bail in all depositors in Australian banks. In short, a foreign-directed banking dictatorship.

And Australian MPs be warned: in Europe, when governments have been forced to bail in their banks under this global BIS regime, angry voters have driven them from office at the first opportunity. That's why APRA needs to be able to exercise these powers independently and secretly.

Replace APRA with Glass-Steagall

The ostensible reason for APRA's powers—to ensure financial stability—is a fraud. APRA will be the cause of the financial crisis it is being given powers to resolve. As the Citizens Electoral Council in Australia, and thousands of politicians, bankers and financial experts around the world, have said since the 2008 GFC, the only way to ensure financial stability is through a Glass-Steagall separation of commercial banks with deposits, from all other financial services. Only this separation will protect the core banking system, which everyone needs, from financial speculation. Australians must get this message through to their MPs.

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 Macquarie's arch-neoliberal philosophy. 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.