

# Citizens Electoral Council of Australia

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Independent Political Party

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## Warning to Australian investors: Beware hybrid securities, aka 'bail-in' bonds!

Australia's big banks are careening along a cliff's edge at breakneck speeds with ordinary investors strapped to their bumpers as human shock absorbers.

Bank regulator APRA is allowing the big banks to sell to unsuspecting Australian investors products that are illegal for banks in other countries to sell to anyone but other financial institutions.

The products are hybrid securities known variously as CoCo (contingent convertible) bonds or bail-in bonds. These complex securities are sold as bank bonds, often bearing a very high interest rate. However, buried in their fine print are numerous triggers that, if the bank gets into trouble, convert the bonds into far less valuable or even worthless shares in the bank.

The investors think they are first in the line of bank creditors and will have their bonds honoured even if the bank fails, only to discover they are holding worthless shares which may or, more likely, may not come good.

Australia's banks are aggressively selling these bail-in bonds to so-called retail investors—mums, dads and retirees. To suck them in, the predatory banks are offering amazingly high interest rates. In February CBA issued a \$910 million tranche of hybrid securities at 7.5 per cent interest—a very generous 5.2 percentage points higher than the standard bank rate. Most hybrid issues are around 3 percentage points higher than the bank rate. "CBA is offering the fattest premium in history", Jonathan Shapiro observed in the 27 February *Australian Financial Review*.

As one market watcher asked, "If you are a self-funded retiree desperate for a return in this low-interest climate, and Australia's biggest and 'strongest' bank, CBA, offers you 7.5 per cent interest on bonds, are you going to think twice about the fine print? Probably not."

In recent weeks, Westpac, NAB and ANZ have all announced big hybrid bond issues, ANZ's being the first US dollar-denominated hybrid since 2008.

In 2014 the UK's Financial Conduct Authority stopped British banks from selling bail-in bonds to retail investors because of the risks associated with the securities that such investors might not readily understand.

It is therefore shocking that in Australia, APRA is allowing the banks to target retail investors with the same products. The banks list their hybrids on the Australian Securities Exchange (ASX) and sell them to individuals via stockbrokers. In his February article the *AFR's* Shapiro noted they are especially targeting self-managed super funds which "have proved to be a deep pool of capital. *These investors know and trust the banks ...*" (Emphasis added.)

This trust in the banks is built on a scaffold of lies peddled by bankers, politicians and the media. Most retail investors wouldn't know, for instance, that:

- During the 2008 global financial crisis when the public was reassured Australia's banks were "sound" the Big Four and Macquarie spent the weekend of 11-12

October on their knees begging the Rudd government for guarantees, without which they would be "insolvent, sooner rather than later".

- Following the GFC, when globally the volume of gambling in derivatives levelled off and even shrank, the derivatives gambling of Australia's banks skyrocketed, doubling between 2009 and 2015 from \$14 trillion to \$28 trillion (now \$32 trillion); in 2012 CBA, which had the fastest growth in derivatives gambling, suddenly and suspiciously stopped disclosing its true derivatives position.

- The big four banks are so exposed to the property bubble in Australia that, when one of any number of triggers bursts that bubble, Australia's banks will suffer the same fate as Ireland's banks in 2008 and go bankrupt.

The hybrids are called "bail-in bonds" because APRA is expected to let Australia's banks count them towards their TLAC—total loss absorbing capacity—which is a requirement of the global "bail-in" regime that the Bank for International Settlements is dictating to the world. Bail-in is intended to preserve Too Big To Fail (TBTF) banks by ensuring that significant losses from their reckless speculation are worn by ordinary depositors and investors, not the banks, so that such losses don't trigger another 2008-style meltdown.

Hence the human shock absorber analogy. The banks are knowingly selling a product that will make unsuspecting investors wear their losses so they can continue recklessly gambling in the property bubble and derivatives. Australia as yet doesn't have depositor bail-in, because the CEC exposed and defeated the plans for such legislation in 2013-14, so APRA is bringing in bail-in through the back door.

### Solution: Investigate the banks; Glass-Steagall

The CEC has been warning about bail-in bonds in our weekly *Australian Alert Service* magazine since the start of the year, after thousands of Italian investors were wiped out by similar products. In the lead-up to and during the federal election, a number of political parties including Labor, the Greens, NXT, Jackie Lambie, and One Nation put an investigation of the banks on to their party platforms. Such an investigation must include APRA's plans for bail-in.

The immediate solution is clear: Glass-Steagall legislation to split up the big four banks and any other conglomerate banks into completely separate institutions—dedicated deposit-taking banks that serve the real economy and are protected by the government on one side, and investment banking, wealth management, stockbroking and insurance businesses on another. Bail-in will destroy people to save banks; Glass-Steagall will save people by dismantling TBTF banks and ensuring real banks are truly sound. The CEC is leading, in Australia, the global campaign to enact Glass-Steagall as the first step to solving the global financial mess that is about to erupt into another crisis. If you want to survive it, and want your country to survive that crisis, join the CEC and campaign for Glass-Steagall.

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## Glass-Steagall debate rages! David Murray attacks calls to break up Big Four banks

As chief executive of the Commonwealth Bank from 1992 to 2005, David Murray presided over its mutation from a public bank that served the community—the “people’s bank”—into a profit-gouging Too Big To Fail (TBTF) conglomerate, which now is at the centre of virtually every financial scandal in Australia.

Small surprise then that Murray has gone into battle for the Big Four conglomerate banks against the Citizens Electoral Council’s call to break up their so-called “vertical integration” with a Glass-Steagall separation of retail banking from investment banking.

Murray defended his old bank and its competitors in a 20 June column in the *Australian Financial Review*, entitled “Why breaking up the banks is ‘not in the national interest’”. In it he effectively admits that they are TBTF and rely on an implicit government guarantee. He argues, however, that the Big Four banks shouldn’t be broken up because Australia needs foreign investment—if the banks weren’t as big as they are they wouldn’t be able to borrow money cheaply on foreign markets. “To break up the major banks would risk access to debt markets and stifle *funding of the economy*”, he wrote. (Emphasis added.)

So let’s just be clear about this argument: to keep the banks intact as conglomerates, their depositors—around 80 per cent of Australians—must wear the risk for anything that goes wrong in their investment banking deals, their stockbroking businesses, their insurance businesses, their wealth management businesses, and the multi-trillions of dollars in derivatives bets the banks have made to hedge their various deals. But, Murray is saying, that risk to depositors is acceptable, because as conglomerates the banks are better positioned to borrow from overseas.

OK, so what have the banks done with this all-important foreign capital that their size enables them to borrow from foreign markets? How precisely have they used it to “fund the economy”? Well, ask a small business owner or a farmer how easy it is to get credit from the banks. In a submission to the 2014 Financial System Inquiry (FSI) that David Murray chaired, former ANZ director John Dahlsen accused the banks of starving businesses and farms of credit.

Instead of lending to productive sectors, the banks have

generally poured every spare cent they can get their hands on into one sector—housing. The hundreds of billions of dollars they have borrowed from overseas has been forced into the over-inflated housing market, creating a real estate bubble that is the greatest single threat to the Australian economy. It is also a threat to the banks themselves, which will be wiped out when the bubble inevitably bursts. Therefore NONE of this foreign borrowing by the Big Four banks has benefited the Australian economy in any way. (The CEC has already refuted the claim that Australia has always depended upon foreign investment.)

As David Murray knows full well, more than 700 Australians, including former Prime Minister Malcolm Fraser, made submissions to his FSI in 2014 calling for Glass-Steagall. His *AFR* column this week proves the CEC has succeeded in igniting in Australia a fierce but subsonic debate on Glass-Steagall that is causing tectonic rumblings among politicians, bankers and financial journalists, but is largely being kept out of earshot of the public by the lying media. (When Eddie McGuire is the lead news story, what is the media *not* reporting?)

This means that the CEC’s Operation Glass-Steagall is working! If Murray, on behalf of his fellow bankers, feels it is necessary to suddenly attack the call to break up the banks, you can be sure that the banks are panicked about losing the ability to gamble with our deposits. That’s good, but it is urgent that we win the fight for Glass-Steagall now, before the next global financial crash hits, which many expect will be soon, so that we can save deposits and banking that serves the real economy.

### What you can do

Get involved in Operation Glass-Steagall:

- If you haven’t yet sent a letter or email to ask your MP if they support a Glass-Steagall separation of the banks to protect Australians from the next financial crash, do it today.
- If you have written to your MP, write to all of the candidates in your electorate with the same question. Contact details for candidates are available at <http://www.aec.gov.au/election/candidates.htm>
- Join the CEC.

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