Citizens Electoral Council of Australia

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Independent Political Party

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A shudder in the stateroom of the Titanic

This release is taken from the editorial of the 6 March 2019 issue of the CEC's Australian Alert Service *magazine.*

"What was that?" Great disasters start with that question. It's being asked now about Suncorp's unexpected 5 March announcement that repayments are in doubt on a $120 million mortgage bond.

Mortgage bonds, a.k.a. mortgage-backed securities, are based on thousands of mortgages that banks lend and then bundle up together to on-sell to investors. The borrower continues to repay the bank, but the bank passes on the repayments to the bondholders.

Suncorp announced that for the bond in question, the proportion of borrowers in arrears on their payments by 60 days or more has risen to 3 per cent, which is three times the rate of arrears of Suncorp's broader mortgage portfolio. This 3 per cent threshold triggers an automatic switch in how the bondholders are paid, with all investors receiving their interest payments, but principal repayments being prioritised to those investors holding the most secure, AAA-rated tranche of the bond.

A nervous *Australian Financial Review* rushed out an article headlined "Suncorp mortgage bond trigger not concerning", which emphasised that no Australian mortgage bond has ever defaulted, but that is precisely the point—is this announcement the first sign of something unexpected? Expert banking analysts have told the *Australian Alert Service* that it is "material" to Suncorp and the financial system.

Suncorp's announcement is reminiscent of the very first sign of the US sub-prime mortgage crisis that triggered the global banking meltdown in 2008. On 8 February 2007, the giant British bank HSBC rocked the markets by announcing a large loss on its US sub-prime mortgage portfolio, caused by rising delinquencies on mortgage repayments. Again, it was unexpected. "This is a material negative surprise for HSBC", a Merrill Lynch analyst told Market Watch that day. It was the beginning of the losses from borrowers falling into arrears on their mortgage repayments that became the fuse that detonated the global financial system.

Most curious about Suncorp's announcement is that it regards a bond issued in 2010, which means that the borrowers have been able to meet their repayments for close to a decade. So why have arrears spiked to 3 per cent now? It coincides with the fall in house prices, which has already trapped more than 400,000 households in negative equity and unable to refinance their loans. It also coincides with other signs of economic decline, including a significant fall in new car sales in February, which Sean Wright in the 5 March *Sydney Morning Herald* called "the canary in the caryard".

If this is happening to people who borrowed at much lower house prices in 2010, what about the more recent borrowers, including the wave of interest-only borrowers from 2012 to 2016? In her March 2018 submission to the banking royal commission, Denise Brailey of the Banking and Finance Consumers Support Association (BFCSA) exposed the tricks banks use to ensure that borrowers, who otherwise can't afford their loans, are able to initially make repayments that go to the bondholders of securitised mortgages. These tricks involve giving the borrowers additional "buffers" for the first five years, including credit cards with $25,000 to $100,000 limits, buffer loans and top-ups, additional lines of credit, and refinancing. "If the applicant runs out of money to pay payments during the first five-year period, the top-ups keep rolling, increasing original debt by an average $150,000", Brailey revealed.

That is an extra $150,000 debt on average for people who couldn't afford the original debt in the first place, all to create a false sense of security for the bondholders who have bought the securitised mortgages. There is a critical mass of these fraudulent loans in the system from 2012 onwards that were made for one purpose—to prop up the housing bubble. If and when defaults rise in those mortgages, expect a chain-reaction meltdown.

Bondholders might be surprised, but the CEC isn't. The international authorities have prepared for this eventuality by developing their policy of "bail-in", to save the financial system by seizing the deposits of bank customers. We must defeat bail-in and instead force through solutions that fundamentally reform the banks to protect the public, including:

- a Glass-Steagall separation of Australia's banks to protect deposits from a financial crash and a bail-in—this will be achieved by passing the Banking System Reform (Separation of Banks) Bill 2019 that Sen. Pauline Hanson introduced on 12 February;
- an independent audit of the big four banks by the Auditor-General to assess how much risk they pose to the economy;
- a moratorium on home and farm foreclosures to stop the banks from saving their own hides in the housing bubble meltdown by forcing hundreds of thousands of families into the street; and
- the other measures in the CEC's 5-point program

What you can do

- Make a submission to the current Senate Economics Legislation Committee inquiry in support of the Separation of Banks bill. The submissions deadline is 12 April, but do it straight away. Visit http://cecaust.com.au/releases/2019_02_18_Submission.html for instructions on making a submission.
- Call the chair and deputy chair of the Senate Economics Legislation Committee to demand they hold public hearings on the Separation of Banks bill, so that the inquiry is transparent and they can get a proper understanding of the need for bank separation from real experts who are not beholden to the banks.

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