

## Submission to the Financial System Inquiry

Dear Mr. Murray,

In this submission I wish to establish three things that your Inquiry need to genuinely address.

- 1) Bail-In won't work.
- 2) Glass-Steagall NOT phony Ring-Fencing
- 3) National Banking, not Too-Big-To-Fail Private banking.

### 1) **Bail-In won't work.**

The Bail-in model, which is being worked on for Australia, and which has already been legislated for around the world in many jurisdictions, simply won't work and is just a sleight of hand trick to get people to believe the age of bail-outs is over. *This Inquiry must reject consideration of the bail-in policy altogether.*

When the next GFC strikes, and when it causes systemic financial catastrophe across the planet, the unsecured creditors of any of the major Too-Big-To-Fail banks will never be able to settle the outstanding debts that those TBTF banks have accrued in the derivatives markets. Governments once again will have to step in and perform bail-outs. Both bail-out and bail-in will be applied together, as it recently was done in Portugal for Banco Espírito Santo. Bail-In *does not* end the era of bail-outs, it actually extends the era of bail-outs by removing the actually necessary consideration of the actual cause of the crisis—Too Big to fail.

Bail-In is a measure that would be applied to keep an insolvent institution alive. In that scenario, the most contagious elements of the banks debt will be settled first, to reduce the crisis spreading to other banks who would be affected by that bank not honouring its debt. As we have seen in the GFC, those debts will be in the form of toxic derivatives no one wants to purchase any more, thus requiring governments to step in and use bail-out to buy up toxic paper, as is ongoing today with Quantitative Easing and TARP, etc.

So, with bail-in enacted, the innocent and ordinary folks (unsecured creditors) will be required to bail-in the most irrational and complex derivatives that are the cause of the crisis in the banking system—a part of the banking system that they have no part in or involvement with directly, let alone understand. Thus, with bail-in, the moral hazard of a "systemically important" bank is transferred from the government to the regular depositors and unsecured creditors within the system. These unsecured creditors also happen to be tax payers, so really, they're one and the same people. Again, it's simply just sleight of hand. Meanwhile, the bank is itself free to continue racking up more speculative debt, knowing that either way, the systemic nature of their institution would be saved at all costs. Many recent reports have indicated that the growth in derivatives debt is once again exploding.

If a bail-in were to occur, who do you actually think will have the priority claim in that scenario? Will it be the depositors? or the derivatives? When you consider this, you will see that the most worthless part of the financial system (derivatives) is being saved, and the most valuable part of the financial system (depositors) are being sacrificed. Not to mention the fact that once a bail-in occurs, bank runs will be inevitable and the confidence in the banking system will certainly die along with it.

### 2) **Glass-Steagall NOT phony ring-fencing**

There has been plenty of debate in the UK and the United States about this issue. Rather than repeat it, I suggest you consider the discussions around it that took place in the UK Parliamentary Committee on Banking Standards from 2012-2013. Their extensive report released July 2013 establishes the need for Glass-Steagall to be sensibly considered. I would go farther than they do for the UK, and demand Glass-Steagall be enacted for Australia in full.

Suppose you were to ask a burglar to design the security of your house. Would that be wise? Suppose you put an arsonist in charge of the local fire brigade. Would that be wise? Well, consider then, putting a committee of bankers in charge of designing ring-fencing. How does a banker improve the culture of banking? Criminals should not be put in charge of deciding their own sentence. The culture of banking is to make lots of money. Fair enough. Just as we are not surprised to find a vulture picking away at a carcass, so too should we not be surprised to find a banker finding every means possible to make lots of money.

However, ring-fencing is so weak, it does not even address the cultural conflict that exists in banking. The temptation will remain and the bankers will exploit the weaknesses of the regulator at every opportunity they get.

Placing the burden on the regulator to police the banks will render the ring-fence impotent, as the process will get drawn out in courts and procedure that the banks will exploit.

We know how burdened the regulators are already, trying to keep the banks in check. Just look at the great job ASIC did keeping a good check on Commonwealth bank and those nasty traders! And now Macquarie. The systemic abuses by banks, such as LIBOR and the GFC in general, will not be addressed by ring-fencing, thus guaranteeing we'll be back in the near future with another GFC

Glass-Steagall, because of the industry wide legal separation it establishes, would remove the burden on the regulators, and make their job easier. We all like less regulation don't we? Ring-fencing introduces all sorts of perverted shades of grey that the banks will easily get around, and it will tie the regulator in knots. Glass-Steagall worked, it was basic, and that is enough for ordinary everyday people.

Complex conglomerate banking only benefits the banks who stand to take advantage of the legal cracks. Ring-fencing is a nothing more than a façade, by which the banking industry will appear to reform itself but will not actually. Take heed of history, and recognise the mistakes that were made by the repeal and weakening of Glass-Steagall from 1980 onward. If you don't want those mistakes to be repeated (once again), reject the impotent ring-fence and go with Glass-Steagall.

### **3) National Banking, not Too-Big-To-Fail Private banking.**

Australia's current "Four pillars" banking system is an insult to the very idea of competition and sensible practice. These banks are TBTF. We have the most concentrated banking system in the world, and this must be changed. The government can, and should institute a National Bank, under a new name if necessary—call it the Commonwealth National Credit Bank if you like—that would use internal sources of credit to invest in nation building works and infrastructure projects. This bank, which would take over the powers of the Reserve Bank of Australia, would also be able to take deposit and issue loans. It would serve as the central bank for the country. This would be a Government Bank, as designed and fought for by King O'Malley.

This bank would require a certain level of capital to be deposited in it by the private banks - let's say 20% capital by each private bank. Just like it used to be before the Commonwealth Bank was turned into a private bank just like all the others. Then we can all say "goodbye!" to all future crises in the banks.

Most Australian's have been tricked into believing that national and state banking is some kind of abomination or abnormality—to be cut out by a doctor or something. However, having a national bank and public banking is commonplace in every part of the world, and prior to the crazy sell-off period in the 80s and 90s, was part of our own national psyche. Look to the fastest growing economies in the world—China, India, Brazil, etc. and consider the fact that all of them have public banks that issue credit for nation building purposes. They use the government owned banks to support farmers and industry. What are we doing?

Ending the dominance of the Big-Four banks and putting in place a strong National Bank does a lot of good for us — it would level the playing field for the private banks, and allow the smaller credit unions and building societies (if there are any left) to once again enter the market. It would also negate the need for bail-in and bail-out. In combination with the Glass-Steagall Law, banking will once again becomes a service and a very uneventful one at that.

Additional measures that should be taken to "level the playing field" and remove the advantage given to the Big-Four by the implicit bail-out guarantee, would be to impose a levy on the Big Four, that would effectively force them over time to reduce their total market share in retail banking, down to no more than a total of 28 per cent between them. This figure is about a third of the current 80 per cent they currently enjoy. With a strong national bank, the private banks would still be able to operate, but will not hold the rest of us to ransom should they take risk and act irresponsibly.

Sincerely,  
**Glen Isherwood**