

Oct 4, 2018

Banking System Reform (Separation of Banks) Bill 2018

There is a pressing need for structural reform in the Australian financial system – mandated through legislative change or other eg the Glass-Steagall Act

I believe that the current Financial Services Royal Commission needs to address reform through *restructuring the financial system*.

The Problem

The financial system is far too complex to administer even for the regulators - eg APRA.

Richard Denniss, Chief Economist, The Australia Institute, writes:

(Oct 3, 2018),

“It is greed that has led Australian banks to steal from dead people.”

Excerpts

“While [the scale of illegality and unethical behaviour in the Australian financial sector](#) might be news to many Australians, the scale of fee-gouging, profiteering and the terrible treatment of customers should be no surprise to our regulators or politicians.

“Not only has the finance industry fought tooth and nail to prevent the introduction of stronger laws that protect consumers from greed, but successive governments, Treasury secretaries and financial regulators have fallen for the banks’ argument that “light touch” regulation is in Australia’s best interests.”

The profitability of the Australian finance sector is built on high fees, useless products, compulsory purchases, weak regulation and even weaker regulators. There is no technological reason the profit margin of Australian banks is so high – the explanations are entirely cultural. As Hayne has shown, the culture of the Australian finance sector is one of greedy suppliers and weak regulators.”

<https://www.theguardian.com/profile/richard-denniss>

Denniss writes (19 Sept, 2018)

“Our regulators fail to protect the vulnerable from the greedy. Let find out why”

Excerpts

“While it is clear that many of our so-called watchdogs are little more than lap dogs, what is less clear is why. It’s time that Australians found out why those tasked with protecting us from exploitation have wound up protecting those who exploit us.”

“...why it is that NGOs and journalists are better at uncovering scandals than the regulatory bodies which are given billions of dollars per year to perform exactly that task?”

“Just because a boxing ring is a level playing field doesn’t make a fight between a heavyweight and a featherweight an even match.”

<https://www.theguardian.com/commentisfree/2018/sep/19/our-regulators-fail-to-protect-the-vulnerable-from-the-greedy-lets-find-out-why>

The big banks in Australia - conglomerates of multiple financial services and business - should be broken up in the best interests of both the public and for the financial health of the country.

Of major concern is:

- The conflict of interests related to the banking and super and insurance industries (eg the financial incentives for cross selling and upselling customers to related financial products whether of genuine benefit to customers or not).
- The never-ending drive by financial institutions to accrue higher profits every year – with little or no due regard for the impact on services or on customers or the wider economy.
- Speculative investing (trading stocks, derivatives, etc). This type of activity adds no “real value” to the economy. It is “numbers on paper”. It fuels hype and fear and interest rate instability. Yet it is a staple method of increasing profits for all financial institutions.

Solution

The whole financial system requires a structural change of entities – mandated by legislation or otherwise. This action is urgently needed.

Implement the Glass-Steagall Act

Enact a law to separate commercial banking from investment banking.

Banks should be broken up into commercial banking and investment banking.

Commercial banking activities:

To include: productive business loans, savings, deposits, pensions, mortgages. This protects traditional savings and bank loans for business purposes, personal loans, and mortgages.

Investment (speculative) banking activities:

To include: funds management, insurance, shadow banking, stock broking, securities, derivatives, CDOs, MBSs, etc. Financial trading and speculation is NOT protected.

Break the banks “vertical integration”

If commercial banks were not “vertically integrated” with wealth management, stock broking, insurance and superannuation, they wouldn’t be able to fleece customers with financial advice that lures them into buying products and investments from the other businesses that the banks own.

Banks should not own super funds because of conflict of interest issues. Super funds exist to look after their members whereas banks are only interested in making profits for shareholders. This sets up a conflict of interest between fund members and bank

shareholders. Typically, bank shareholders “loot” profits from super funds. This needs to be removed.

Commissioner Kenneth Hayne’s interim report of the Financial Services Royal Commission

The report cites the precedent of the Glass-Steagall Act, and seeks submissions on questions of the structure of regulation and the structure of the banks.

Questions raised:

Commissioner Hayne: Simplify the financial services sector?

As indicated in Chapter 8, I begin from the premise that no new layer of law or regulation should be added unless there is clearly identified advantage to be gained by doing that. And I begin from the further premise that very simple ideas must inform the conduct of financial services entities.

Hence, the first question to be asked and answered is:

- Is the law governing financial services entities and their conduct too complicated?
- Does it impede effective conduct risk management?
- Does it impede effective regulatory enforcement?
- Is the regulatory regime too complex?
- Should there be radical simplification of the regulatory regime?

Reply

Yes, to all of the above.

Commissioner Hayne: - APRA?

- Are APRA’s regulatory practices satisfactory? If not, how should they be changed?
- Are APRA’s enforcement practices satisfactory? If not, how should they be changed?
- Does the conduct identified and criticised in this report call for reconsideration of APRA’s prudential standards on governance?

Reply

- No, APRA’s behaviour is not satisfactory.
- Using the excuse of financial stability APRA has allowed the banks to engage in practices that maximise their profits, but at the expense of their customers.
- Ultimately, this has become a threat to financial stability, because in seeking to increase their profits from mortgages the banks have inflated a massive housing bubble and incurred a \$40 trillion exposure to dangerous derivatives, all of which is a threat to the financial system.

Commissioner Hayne: 7.5 Business structures?

- Do the events that have happened raise any issue about business structures?

- Do the events that have happened invite consideration of whether structural changes should now be made?
- Do the events that have happened suggest that manufacturers of financial products should not be permitted to provide, whether by employee or authorised representative, personal financial advice in relation to products of a kind it manufactures?

Reply

- Yes, the banks' structure, a.k.a. vertical integration, create conflicts of interest between serving their customers, and exploiting their customers to maximise profits for shareholders.
- The banks cannot be trusted to "manage" these conflicts of interest and relying on more rigorous law enforcement is unrealistic.
- The conflicts of interest must be removed, by separating commercial banks from all other businesses.

Commissioner Hayne: What responses should be made to the conduct identified and criticised in this report?

- Are changes in law necessary?
- Should the financial services law be simplified?
- Should the regulatory architecture change?
- Is structural change in the industry necessary?

Reply

- Yes, to all of the above.
- The solution is in legislation that is already before Parliament, the [Banking System Reform \(Separation of Banks\) Bill 2018](#), introduced by the Member for Kennedy, Bob Katter on 25 June.
- It will enact a Glass-Steagall separation of commercial banks from investment banking and all other financial business, and bring APRA under much tighter Parliamentary control.

Conclusion

Legislate a Glass-Steagall Act to restructure the financial sector and address commercial interests versus investment (speculative) interests – as mentioned above.