PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

Review of the Four Major Banks: First Report

House of Representatives Standing Committee on Economics

November 2016
CANBERRA

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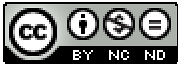

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Chair's foreword

Banking regulation should have two key goals: promoting financial stability and achieving strong outcomes for consumers. Financial stability is critical – but so is ensuring that consumers get a fair deal from the banking sector.

Due to Australia's strong regulatory framework and the banking sector's prudent management of financial risk, no Australian bank regulated by the Australian Prudential Regulation Authority (APRA) has ever failed. We need only consider the economic impact of bank failures in other nations to understand the importance of a stable banking system.

However, while they have remained financially strong, Australia's major banks have let Australians down too frequently in too many other ways.

Australians turn to banks for assistance when making some of the most important decisions and facing some of the most serious challenges of their lives: borrowing to buy their first home; investing to support their retirement; and, in some cases, accessing insurance policies that they had hoped they would never need.

Australians should be able to trust that their bank will act in their best interests when they turn to them for help. It is clear that in some cases this has not happened.

The Government and regulators recognise this and are taking steps to remedy the failings that have occurred. This committee's inquiry into the conduct of Australia's major banks is an important part of this process.

This inquiry offers the banking sector the chance to transparently account for its conduct. This is a critical opportunity for an industry that has too often failed to live up to the expectations of Australians.

The committee's investigation of these issues will help hold the industry to account while informing future policy changes.

While the committee strongly endorses the measures being implemented to reform the banking sector, it is clear that gaps remain.

Australia's banking sector is an oligopoly. The major banks have significant market power that they use to protect shareholders from regulatory and market developments.

Despite this market concentration, under our current regulatory structure no entity is tasked with regularly making recommendations to improve competition. This must change.

The culture of Australia's financial sector also needs to be reformed. While significant changes have been announced that will better protect consumers, not enough has been done to force banks' senior leaders to change their behaviour. When consumers are continually let down, senior executives should go.

In addition, when things do go wrong, consumers and small businesses need one place to go where disputes can be quickly and easily handled. This does not yet exist.

To fill these gaps in the reform agenda and deliver better outcomes for consumers, the committee's recommendations include:

- the launch of a 'one stop' Banking and Financial Services Tribunal to replace the existing external dispute resolution schemes by 1 July 2017;
- public reporting of significant regulatory breaches, including the names of relevant senior executives and the consequences that they faced, as well as enforcement action in the wealth management industry;
- continual monitoring of competition in Australia's banking sector;
- the creation of a data sharing framework for consumers' and small businesses' data by July 2018; and
- a review of the regulatory barriers to starting a bank.

The committee looks forward to the Government's response to the recommendations contained in this report.

David Coleman MP
Chair

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Membership of the Committee

Chair

Mr David Coleman MP

Deputy Chair

Hon Matt Thistlethwaite MP

Members

Mr Adam Bandt MP

Ms Julia Banks MP

Mr Scott Buchholz MP

Mr Pat Conroy MP (to 7 November 2016)

Mr Trevor Evans MP

Mr Kevin Hogan MP

Mr Craig Kelly MP

Mr Matt Keogh MP

Ms Madeleine King MP (from 7 November 2016)

Committee Secretariat

Stephen Boyd, Committee Secretary

Ryan Walsh, Inquiry Secretary

Jazmine Rakic, Office Manager

Terms of Reference

On 15 September 2016, the Treasurer requested that the House of Representative's Standing Committee on Economics undertake – as a permanent part of the committee's business – an at least annual inquiry into:

- the performance and strength of Australia's banking and financial system;
- how broader economic, financial, and regulatory developments are affecting that system; and
- how the major banks balance the needs of borrowers, savers, shareholders, and the wider community.

In undertaking its inquiry, the committee was asked to hold at least annual public hearings with the four major banks, with a particular focus on the banks' perspectives on:

- domestic and international financial market developments as they relate to the Australian banking sector and how these are affecting Australia;
- developments in prudential regulation, including capital requirements, and how these are affecting the policies of Australian banks;
- the costs of funds, impacts on margins and the basis for bank pricing decisions; and

- how individual banks and the banking industry as a whole are responding to issues previously raised in Parliamentary and other inquiries, including through the Australian Bankers' Association's April 2016 six point plan to enhance consumer protections and in response to Government reforms and actions by regulators.

In undertaking its inquiry, the committee was also asked to, as appropriate, engage with Australia's key economic regulators and give due consideration to the Government's Financial System Program and other relevant financial sector reforms and reviews.

Abbreviations

ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
ACCP	Australian Council for Competition Policy (proposed)
ADI	Authorised Deposit-taking Institution
AFSL	Australian Financial Services License
ANZ	Australian and New Zealand Banking Group
API	Application Programming Interface
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
BSB number	Bank-State-Branch number
CBA	Commonwealth Bank of Australia
CEO	Chief Executive Officer
CMA	Competition and Markets Authority (UK)
CIO	Credit and Investments Ombudsman
EDR	External Dispute Resolution

FCA	Financial Conduct Authority (UK)
FOFA	Future of Financial Advice
FOS	Financial Ombudsman Service
FSI	Financial System Inquiry
FSSA	*Financial Sector (Shareholdings) Act 1998*
GDP	Gross Domestic Product
GFC	Global Financial Crisis
IDR	Internal Dispute Resolution
IRB model	Internal Ratings Based model
NAB	National Australia Bank
NPP	New Payments Platform
ODI	Open Data Institute
PRA	Prudential Regulation Authority (UK)
RBA	Reserve Bank of Australia
SCT	Superannuation Complaints Tribunal
SMR	Senior Managers Regime (UK)
SVR	Standard Variable Rate
TBTF	Too-big-to-fail
UK	United Kingdom

Recommendations

Recommendation 1

2.1 The committee recommends that the Government amend or introduce legislation, if required, to establish a Banking and Financial Sector Tribunal by 1 July 2017. This Tribunal should replace the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

2.2 The Government should also, if necessary, amend relevant legislation and the planned industry funding model for the Australian Securities and Investments Commission, to ensure that the costs of operating the Tribunal are borne by the financial sector.

Recommendation 2

3.1 The committee recommends that, by 1 July 2017, the Australian Securities and Investments Commission (ASIC) require Australian Financial Services License holders to publicly report on any significant breaches of their licence obligations within five business days of reporting the incident to ASIC, or within five business days of ASIC or another regulatory body identifying the breach.

3.2 This report should include:

- a description of the breach and how it occurred;
- the steps that will be taken to ensure that it does not occur again;

- the names of the senior executives responsible for the team/s where the breach occurred; and
- the consequences for those senior executives and, if the relevant senior executives were not terminated, why termination was not pursued.

Recommendation 3

4.1 The committee recommends that the Australian Competition and Consumer Commission, or the proposed Australian Council for Competition Policy, establish a small team to make recommendations to the Treasurer every six months to improve competition in the banking sector.

4.2 If the relevant body does not have any recommendations in a given period, it should explain why it believes that no changes to current policy settings are required.

Recommendation 4

5.1 The committee recommends that Deposit Product Providers be forced to provide open access to customer and small business data by July 2018. ASIC should be required to develop a binding framework to facilitate this sharing of data, making use of Application Programming Interfaces (APIs) and ensuring that appropriate privacy safe guards are in place. Entities should also be required to publish the terms and conditions for each of their products in a standardised machine-readable format.

5.2 The Government should also amend the *Corporations Act 2001* to introduce penalties for non-compliance.

Recommendation 5

5.38 The committee recommends that the Government, following the introduction of the New Payments Platform, consider whether additional account switching tools are required to improve competition in the banking sector.

Recommendation 6

6.1 The committee recommends that by the end of 2017:

- the Government review the 15 per cent threshold for substantial shareholders in Authorised Deposit-taking Institutions (ADIs) imposed by the *Financial Sector (Shareholdings) Act 1998* to determine if it poses an undue barrier to entry;

- the Council of Financial Regulators review the licensing requirements for ADIs to determine whether they present an undue barrier to entry and whether the adoption of a formal 'two-phase' licensing process for prospective applicants would improve competition; and

- APRA improve the transparency of its processes in assessing and granting a banking licence.

Recommendation 7

7.1 The committee recommends that the major banks be required to engage an independent third party to undertake a full review of their risk management frameworks and make recommendations aimed at improving how the banks identify and respond to misconduct. These reviews should be completed by July 2017 and reported to ASIC, with the major banks to have implemented their recommendations by 31 December 2017.

Recommendation 8

8.1 The committee recommends that the Government amend relevant legislation to give the Australian Securities and Investments Commission (ASIC) the power to collect recurring data about Australian Financial Services licensees' Internal Dispute Resolution (IDR) schemes to:

- enable ASIC to identify institutions that may not be complying with IDR scheme requirements and take action where appropriate; and

- enable ASIC to determine whether changes are required to its existing IDR scheme requirements.

8.2 The committee further recommends that ASIC respond to all alleged breaches of IDR scheme requirements and notify complainants of any action taken, and if action was not taken, why that was appropriate.

Recommendation 9

9.1 The committee recommends that the Australian Securities and Investments Commission (ASIC) establish an annual public reporting regime for the wealth management industry, by end-2017, to provide detail on:

- the overall quality of the financial advice industry;
- misconduct in the provision of financial advice by Australian Financial Services Licence (AFSL) holders, their representatives, or employees (including their names and the names of their employer); and
- consequences for AFSL holders' representatives guilty of misconduct in the provision of financial advice and, where relevant, the consequences for the AFSL holder that they represent.

9.2 The committee further recommends that ASIC report this information on an industry and individual service provider basis.

Recommendation 10

9.21 The committee recommends that, whenever an Australian Financial Services Licence (AFSL) holder becomes aware that a financial advisor (either employed by, or acting as a representative for that licence holder) has breached their legal obligations, that AFSL holder be required to contact each of that financial advisor's clients to advise them of the breach.

1. Introduction

1.1 Australia's major banks – the Commonwealth Bank of Australia (CBA), Australia and New Zealand Bank (ANZ), National Australia Bank (NAB) and Westpac – are full-service institutions that offer:

- retail, corporate and commercial banking services;
- financial advice;
- institutional banking; and
- wealth management (including superannuation).

1.2 They are extremely dominant in Australia's financial system. As of September 2016, they collectively held around:

- $2.8 trillion in Australian resident assets (equal to approximately twice Australia's annual gross domestic product (GDP));
- $1.2 trillion in mortgages (about 83 per cent of the market); and
- $570 billion in business loans (about 74 per cent of the market).[1]

1.3 Their market dominance, coupled with a number of structural features of Australia's financial system, has left them with significant market power.

1.4 The House of Representative's Standing Committee on Economics' (the committee) concerns about the major banks, however, extend well beyond their use of market power.

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[1] APRA, *Monthly Banking Statistics September 2016*, October 2016, Table 2.

1.5 Over the past decade numerous scandals have occurred and allegations have been raised in relation to: poor financial advice; the maladministration of life insurance claims; and market manipulation (among other issues).

1.6 These continued claims of misconduct suggest that the culture of these institutions is often not one that has consumers at its centre. This must be rectified.

Conduct of the Inquiry

1.7 On 13 September 2016, the Treasurer formally requested that the committee undertake an at least annual inquiry into the performance and conduct of Australia's major banks.

1.8 Between 4 October and 6 October 2016, the committee held three-hour public hearings with each of the major banks.

1.9 The proceedings of the hearing were webcast over the internet, through the Parliament's website, allowing interested parties to view or listen to the proceedings as they occurred. The transcripts of each of the public hearings are available on the committee's website: http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Public_Hearings.

1.10 Following these hearings, the committee sent letters to each of the major banks' Chief Executive Officers (CEOs) seeking responses to questions on notice as well as a range of additional information on specific issues of concern to the committee including:

- details on the major banks' investigations into specific instances of misconduct;
- consequences for responsible senior executives when misconduct has occurred;
- examples of the balanced scorecards that the banks use to appraise their employees;
- loss rates on small and large business loans; and
- internal whistle-blowing processes.

1.11 The banks' responses to these additional requests, excluding information that was reported to be commercial in confidence, are available on the committee's website: http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Documents.

Reader's guide and structure of the report

1.12 Section 2 investigates the complexity of Australia's existing system of External Dispute Resolution (EDR) schemes and concludes that it is not working effectively for consumers. In its place, the committee recommends that the Government establish a 'one stop' Banking and Financial Services Tribunal.

1.13 Section 3 considers whether Australia's regulatory system does enough to hold senior executives to account for institutional failures. The committee recommends that Australian Financial Services Licence (AFSL) holders be required to publicly report on breaches and name the relevant division's senior executives.

1.14 Sections 4, 5 and 6 consider competition in Australia's banking sector. In particular, they focus on the structural features of Australia's financial system that act as barriers to competition and make recommendations to increase the competitiveness of the market. These include:

- regular monitoring and reporting on market practices that may be limiting competition in the banking sector;
- the introduction of a data sharing framework to empower consumers; and
- a review of bank licensing and other regulatory entry requirements.

1.15 Sections 7 and 8 explore the major banks' Internal Dispute Resolution (IDR) schemes and risk management frameworks. In the committee's view, both have flaws that are contributing to poor consumer outcomes. To remedy this, the committee recommends that:

- the Australian Securities and Investments Commission (ASIC) be given greater power to monitor industry's compliance with IDR requirements; and

- formal independent reviews of each of the major banks' risk management frameworks be undertaken to improve the identification and prevention of misconduct.

1.16 Section 9 discusses the systemic problems that exist within Australia's wealth management framework and the measures being taken to address them. It recommends that these measures be supplemented by additional reporting on misconduct in the industry to improve outcomes for consumers and industry culture.

2. Establish a Banking Tribunal

> In terms of dispute resolution mechanisms...if there are other mechanisms for people to take their disputes, particularly people without much resources who are in dispute with a very large entity, as a general proposition that really does improve access to justice. *Mr Rod Sims, Chairman of the ACCC*[1]

Recommendation 1

2.1 The committee recommends that the Government amend or introduce legislation, if required, to establish a Banking and Financial Sector Tribunal by 1 July 2017. This Tribunal should replace the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

2.2 The Government should also, if necessary, amend relevant legislation and the planned industry funding model for the Australian Securities and Investments Commission, to ensure that the costs of operating the Tribunal are borne by the financial sector.

2.3 Australia's system of EDR schemes is overly complex and overly legalistic. Too often, consumers and small businesses are not able to access justice.

2.4 Currently there are two EDR schemes authorised by ASIC. These are:

1 Mr Rod Sims, Chairman of the ACCC, *Committee Hansard*, 14 October 2016, pp. 14-15.

1. the Financial Ombudsman Service (FOS), which deals with complaints across a diverse range of financial services (including complaints relating to most Authorised Deposit-taking Institutions (ADIs)); and
2. the Credit and Investments Ombudsman (CIO), which broadly handles complaints about some credit unions and building societies as well as a range of non-bank lenders.

2.5 In addition to the FOS and CIO, the Superannuation Complaints Tribunal (SCT), an independent government body, handles complaints relating to superannuation funds, annuities, deferred annuities and retirement savings accounts.

2.6 This system, given the various schemes' overlapping jurisdictions, can create confusion. For example:

- a customer in a dispute with a major bank would need to approach the FOS;
- a customer in a dispute with a credit union would need to approach either the FOS or the CIO, depending on which scheme the credit union was a member of; and
- a customer in a dispute with a bank or a credit union relating to a retirement savings account would generally need to approach the SCT.

2.7 In addition to creating confusion for consumers, the existing multi-scheme framework is very duplicative. As noted by ASIC, each EDR scheme currently has its own:

- board of directors;
- case management systems and support infrastructure;
- administration and regulatory reporting arrangements for licensees and representatives including members switching schemes; and

- statistical, systemic issues and serious misconduct processes and reporting requirements. [2]

2.8 The CIO have argued that this duplication was justified because the 'existence of two ASIC-approved EDR schemes allows each scheme to benchmark its performance against the other...[which] produces better outcomes for FSPs [financial services providers], consumers and regulators.'[3] The committee does not find this argument persuasive for two reasons.

2.9 Firstly, tribunals operating in other industry sectors (and the courts system) manage to deliver good outcomes for consumers without competition between duplicative schemes.

2.10 Secondly, given difficulties in comparing and ensuring consistent outcomes for FOS and CIO complainants (due to the use of conciliation and different reporting standards)[4] – a significant problem in its own right – it is hard to imagine how the benchmarking referred to by the CIO could meaningfully occur.

2.11 The scope of existing schemes is also inadequate. For example:

- the FOS and CIO can only consider complaints where the damages are alleged to be $500,000 or lower. This is a demonstrably inadequate amount given numerous instances where people are alleged to have lost millions as a consequence of poor financial advice;[5] and
- not all business lenders have to be a member of an EDR. This can force small businesses to rely on the courts.

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2 ASIC, *Review of the financial system external dispute resolution framework: Submission by the Australian Securities and Investments Commission*, October 2016, p. 30.

3 CIO, *Credit and Investments Ombudsman's response to the Issues Paper for the Review of External Dispute Resolution schemes*, October 2016, p. 2.

4 ASIC, *Review of the financial system external dispute resolution framework: Submission by the Australian Securities and Investments Commission*, October 2016, p. 29.

5 A. Ferguson, 'Misconduct claims widen in CBA's planning scandal', *The Sydney Morning Herald*, 14 June 2014, <http://www.smh.com.au/business/misconduct-claims-widen-in-cbas-planning-scandal-20140613-3a2wn.html>, viewed 20 October 2016.

2.12 Given the system's shortcomings, the committee endorses the Government's decision to:

- conduct a review, Chaired by Professor Ian Ramsay, of Australia's external dispute resolution and complaints schemes; and
- have ASIC and the FOS conduct a concurrent review of the FOS's small business jurisdiction.

2.13 As these inquiries are ongoing, the committee will not make firm recommendations on appropriate complaint or compensation limits. As a general observation, however, the committee is of the view that both should be increased.

2.14 The committee does recommend that the Government replace the three existing EDR schemes with a 'one-stop' Banking and Financial Services Tribunal to handle complaints from consumers and small businesses. It should:

- reduce confusion for consumers;
- enhance small businesses' EDR scheme coverage;
- help ensure consistent outcomes for complainants; and
- improve scheme efficiency by eliminating unnecessary duplication.

2.15 The committee is aware of the concerns that a number of consumer groups have with the establishment of a tribunal (though notes that they do support the consolidation of the existing EDR schemes).[6]

2.16 In the committee's view it is critical that, if the Government were to proceed with the establishment of a tribunal, these concerns be adequately addressed.

2.17 To help address many of the consumer groups' concerns, the committee proposes that the new banking and financial services tribunal have the following features. It should:

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6 Care Inc et al., *Submission to Review of the Financial System Dispute Resolution Framework – Issues Paper*, 10 October 2016, p. 3.

- be free for consumers to access;
- have equal numbers of consumer and industry representatives on its board;
- require all firms holding a relevant ASIC or APRA licence (in the case of superannuation/retirement savings account's providers) to be a member;
- operate without lawyers (to the extent possible);
- be funded directly by the financial services industry;[7]
- have the power to refer potential systemic issues to ASIC for formal investigation. For example, this could occur when the tribunal receives a large number of similar complaints over a year; and
- make decisions that are binding on member institutions.

Existing External Dispute Resolution schemes

2.18 Currently, all AFSL holders, unlicensed product issuers, unlicensed secondary sellers, ACL holders and credit representatives are required to have a dispute resolution system that consists of:

- internal dispute resolution (IDR) procedures that meet ASIC standards; and
- membership of one or more ASIC-approved EDR schemes (that is, the FOS or the CIO).[8]

2.19 Additional detail on the three existing EDR schemes is provided in Table 2.1.

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[7] If direct industry funding is not possible, the government should recover any appropriated amounts from the financial services industry. Under such a model, appropriations to the body should respond to the number of cases that the tribunal handles each year.

[8] ASIC, *Regulatory Guide 165 Licensing: Internal and external dispute resolution*, July 2015, p. 4.

Table 2.1 Overview of Australia's External Dispute Resolution schemes

Scheme	Jurisdiction	Complaint Cap	Compensation Cap
FOS	Handles complaints against banks, credit unions, foreign exchange dealers, deposit takers, credit providers, mortgage brokers, general insurers, insurance brokers, life insurers, funds' managers, financial advisers and planners, stockbrokers and some superannuation providers.	\$500,000	\$309,000[9]
CIO	Handles complaints about credit unions, building societies, non-bank lenders, mortgage and finance brokers, financial planners, lenders and debt collectors, credit licensees and credit representatives.	\$500,000	\$309,000
SCT	Handles complaints about superannuation funds, annuities and deferred annuities and retirement savings accounts.	Uncapped	Uncapped

Source: ASIC, FOS, CIO, and SCT

9 Separate caps apply for general insurance broking (\$166,000), income stream life insurance (\$8,300 per month) and uninsured third party motor vehicle claims (\$5,000).

The Financial Ombudsman Service

2.20 The creation of the FOS provides a useful precedent for the establishment of a 'one-stop' banking tribunal.

2.21 On 1 July 2008, the FOS was formed by the merger of three existing ASIC-approved EDR schemes:

- the Banking and Financial Services Ombudsman;
- the Insurance Ombudsman Service Limited; and
- the Financial Industry Complaints Service.

2.22 Two other pre-existing ASIC-approved EDR schemes also joined FOS:

- the Credit Union Dispute Resolution Centre; and
- the Insurance Brokers Disputes Limited.

2.23 When the FOS was launched, Mr Colin Neave AM (the FOS's inaugural Chief Ombudsman) stated that:

> Both industry and consumers will benefit from the creation of the new Financial Ombudsman Service...By simplifying the structure of financial services dispute resolution, the new Financial Ombudsman Service will allow greater consumer awareness of the service and will be more streamlined and efficient and able to respond when there are peaks in demand.[10]

2.24 These arguments were compelling in 1998. They remain compelling now.

Funding External Dispute Resolution schemes

2.25 To ensure that the financial sector has an incentive to minimise complaints, it is critical that EDR schemes are industry funded.

2.26 While the FOS, CIO and SCT are all funded by the financial sector they use significantly different models.

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10 Financial Ombudsman Service, 'New National Financial Services Ombudsman Launched', *Media Release*, 10 July 2008, <www.fos.org.au/public/download/?id=3027&sstat=341803>, viewed 28 October 2016.

- The FOS and CIO are funded directly by members (that is, they do not receive a government appropriation). Each member is required to pay regular membership fees, as well as additional fees related to the number of complaints that the EDR receives relating to their operations.
- The SCT is funded by government appropriation. The costs of the SCT are recovered from the superannuation industry by APRA and returned to consolidated revenue. There is no direct link between the SCT's funding and complaints received.

2.27 The committee believes that direct funding is preferable to cost recovery. This is because:

- it is administratively simpler;
- it is more responsive to the number of complaints received (because additional funding does not require a government appropriation); and, for this reason,
- it provides additional incentives for AFSL holders to resolve disputes prior to them being referred to an EDR scheme.

2.28 Timely dispute resolution is critical in situations where consumers may have suffered substantial financial losses. This depends on adequate EDR scheme resourcing. The committee therefore recommends that the proposed Banking and Financial Services Tribunal be funded directly by industry.

3. Make Executives Accountable

> "There are certainly individuals...who have had some consequences relating to remuneration...we have not had individuals terminated" *Mr Ian Narev, CEO of the Commonwealth Bank on the mishandling of claims in CommInsure*[1]

> "It is not just a problem with the bad apples; there is generally often a problem with the tree...let us deal with the tree" *Mr Greg Medcraft, ASIC Chairman*[2]

Recommendation 2

3.1 The committee recommends that, by 1 July 2017, the Australian Securities and Investments Commission (ASIC) require Australian Financial Services License holders to publicly report on any significant breaches of their licence obligations within five business days of reporting the incident to ASIC, or within five business days of ASIC or another regulatory body identifying the breach.

3.2 This report should include:

- **a description of the breach and how it occurred;**
- **the steps that will be taken to ensure that it does not occur again;**
- **the names of the senior executives responsible for the team/s where the breach occurred; and**

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1 Mr Ian Narev, CEO of CBA, *Committee Hansard*, 4 October 2016, p. 16.

2 Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard,* 14 October 2016, p. 3.

- **the consequences for those senior executives and, if the relevant senior executives were not terminated, why termination was not pursued.**

3.3 The FSI concluded that the interests of financial firms and consumers are not always aligned.[3] The major banks' appearance before the committee confirmed it.

3.4 According to the evidence presented, no senior executives have so far been terminated in relation to the extremely serious cases of:

- the provision of poor financial advice at NAB;[4] and
- the mishandling of life insurance claims at CommInsure.[5]

3.5 Similarly, no senior executive was terminated following:

- NAB's failure to pay 62,000 wealth management customers the amount that they were owed;[6]
- the poor administration of hardship support at CBA;[7]
- ANZ's OnePath improperly collecting millions of dollars in fees from hundreds of thousands of customers; [8] and
- ANZ improperly collecting fees from 390,000 accounts that had not been properly disclosed.
  - In regards to ANZ's improper collection of fees, the bank did not believe that any staff members were responsible for the breach because:

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[3] D. Murray et al., Financial System Inquiry, *Final Report*, 2014, p. 217.

[4] Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 4.

[5] Mr Ian Narev, CEO of CBA, *Committee Hansard*, 4 October 2016, p. 16.

[6] Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 5.

[7] CBA, *Response to Questions on Notice: Question Six*, 18 October 2016, p. 6.

[8] Mr Shayne Elliot, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 40.

> The issue existed for a number of years...and there have been a number of organisational and staffing changes through that period.[9]

3.6 This is unacceptable and clearly demonstrates the accountability deficit that exists within these organisations.

3.7 The major banks seem to believe that it is appropriate that no senior executive has been terminated for these failings and that a reduction in responsible executives' remuneration will be sufficient to improve consumer outcomes. For example, Mr Andrew Thorburn, NAB's CEO, noted that:

> I think the people in this line of business definitely feel accountable...I think reputations have suffered.[10]

3.8 NAB also argued that more severe consequences for executives were not appropriate because they were not directly responsible for the misconduct. For example, in justifying his decision not to terminate any executives, Mr Thorburn stated that 'the [financial] planners were the culpable parties, really.'[11]

3.9 The committee disagrees with this assessment.

3.10 The major banks have a 'poor compliance culture'[12]and have repeatedly failed to protect the interests of consumers.[13]

3.11 This is a culture that senior executives have created.[14]It is a culture that they need to be held accountable for.

3.12 The committee is aware of the progress that is being made to improve culture and accountability within the sector. The committee supports:

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9 ANZ, *Response to Questions on Notice: Question Two*, 27 October 2016, p. 3.

10 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 5.

11 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 10.

12 Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 5.

13 D. Murray et al., Financial System Inquiry, *Final Report*, October 2014, p. 218.

14 APRA, *Information Paper: Risk Culture*, October 2016, p. 16.

- the Government's decision to allow ASIC to ban managers guilty of poor conduct from operating in the financial services industry;
- the industry's work to develop a register of 'rogue' employees to help ensure that they cannot rotate between financial services firms; and
- Mr Stephen Sedgwick AO's review of commissions and payments (including referral payments) made to bank staff and third parties to ensure that they do not encourage behaviour contrary to consumers' interests.

3.13 However, even with these measures in place gaps will remain.

3.14 Clearly there will be some cases where an executive's conduct has been sufficient to justify banning. However, not all misconduct is severe enough to warrant ASIC taking this action.

3.15 The proposed framework does not strengthen the consequences for responsible executives where banning would be excessive, but where mere reputational or remunerative penalties are grossly inadequate.

3.16 To fill this gap, and better align executives and consumer interests, the committee recommends that ASIC require all AFSL holders to publicly report on any significant breaches of their regulatory obligations within five business days of reporting the breach to ASIC, or within five business days of ASIC or another regulatory body identifying that breach.

3.17 Critically, in addition to explaining how the breach occurred and what steps will be taken to ensure that the breach does not occur again, the report should include:

- the names of the senior executive/s responsible for the team/s where the breach occurred; and
- the consequences for those senior executives and, if this did not include termination, why termination was not appropriate.

3.18 The committee believes that this will have two significant benefits:

1. the risk of being publicly named will create further incentives for executives to prioritise good consumer outcomes; and
2. the need for AFSL holders to publicly justify the consequences imposed on senior executives will force institutions to more comprehensively engage with questions of executive accountability on a more regular basis.

3.19 To further increase institutional accountability these reports should be sequentially numbered so that consumers and investors can easily determine how many significant breaches a licensee has had in a given year.

Australia's breach reporting framework

3.20 AFSL holders must advise ASIC in writing as soon as practicable (and within 10 business days) about any significant breach (or likely significant breach) of sections 912A, 912B and 912A(1)(c) of the *Corporations Act 2001*.

3.21 In 2015-16, ASIC received 1,172 breach reports from AFSL holders and managed investment schemes.[15]

3.22 Table 3.1 summarises the obligations that, if not met by an AFSL holder, could trigger the need for a breach report.

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15 ASIC, *ASIC Annual Report 2015-16*, 31 October 2016, p. 93.

Table 3.1 Australian Financial Services License obligations that can trigger a breach report

Obligations under sections 912A and 912B	Obligations under section 912A(1)(c)
An AFSL holder must: • do all things necessary to ensure that the financial services covered by your AFS licence are supplied efficiently, honestly and fairly; • have adequate resources to provide the financial services covered by your licence and to carry out supervisory arrangements (unless you are regulated by APRA); • be competent to supply the financial services covered by your licence; • have trained and competent representatives; • take reasonable steps to ensure that your representatives comply with the financial services laws; • have a dispute resolution system for retail clients; • have adequate risk management systems; and • have compensation arrangements for retail clients.	An AFSL holder must comply with the following financial services laws: • Chapter 6 of the Corporations Act (takeovers); • Chapter 6A of the Corporations Act (compulsory acquisitions and buy-outs); • Chapter 6D of the Corporations Act (fundraising); • Chapter 7 of the Corporations Act (financial services and markets); and • Division 2 of Part 2 of the ASIC Act (unconscionable conduct and consumer protections for financial services).

Source: ASIC, Regulatory Guide 78: Breach reporting by AFS licensees, p. 6.

3.23 A failure to report is also a significant breach. This has a maximum penalty of $42,500 for a company and $8,500 or imprisonment for one year (or both) for an individual.

3.24 Under this framework, breaches that must be reported to ASIC include failures such as:

- an AFSL holder or their representatives providing inappropriate financial advice to clients;
- fraud by an AFSL holder or their representatives or the AFSL holder's failure to prevent that fraud from occurring;
- the AFSL holder or their representatives supplying financial services that they are not licensed to supply; and
- an AFSL holder's failure to detect previous breaches.

3.25 When such a breach is detected, the AFSL holder must report to ASIC on:

- the type of breach (or likely breach), why it was significant, and how long it lasted;
- how the breach (or likely breach) was detected;
- information on any authorised representatives involved in the breach (or likely breach); and
- how the breach (or likely breach) has been rectified as well as the steps that will be taken to ensure that it does not happen again.

3.26 The committee believes that expanding this framework to include public reporting of this information, as well as additional detail on the consequences for responsible executives, is an appropriate response to the numerous cases of serious misconduct that have occurred in recent years.

3.27 Notwithstanding this conclusion, the Government – as part of its review of ASIC's enforcement regime (which includes a review of penalties and the financial services licensing breach notification network) – should consider whether additional penalties are required to support a more public breach reporting regime.

Potential future reforms

3.28 The committee is committed to increasing executive accountability in the financial sector.

3.29 In seeking to achieve this outcome, the UK recently published new rules for senior managers. These are known as the Senior Managers Regime (SMR).

3.30 The SMR introduces specific prescribed responsibilities for senior managers (among other measures) and is expected to focus supervision and enforcement action on the actions of individual managers rather than the overall actions of the institution.[16]

3.31 The committee is aware of potential problems with the SMR. In particular, concerns that parts of the regime may undermine businesses' internal accountability structures[17] and that the SMR runs counter to traditional concepts of criminal and civil liability.[18]

3.32 The committee will monitor the effectiveness of the UK's regime as well as reforms announced but not yet enacted in Australia and consider the need for additional reforms throughout future inquiries.

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16 Deloitte, *Senior Managers Regime Individual Accountability and Reasonable Steps*, 2016, p. 5.

17 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 11.

18 Argent, J and Colvin, J, 'Liability for Corporate Culture, *Company Director*, Vol. 31. No. 11. December 2015-January 2016, p. 57.

4. Require New Focus on Banking Competition

"There seems a lack of very robust competition in banking...We are not seeing as much robust competition as we would like"*Rod Sims, Chairman of the Australian Competition and Consumer Commission*[1]

"We are in a market which is, frankly, an oligopoly" *Greg Medcraft, Chairman of the Australian Securities and Investments Commission*[2]

Recommendation 3

4.1 The committee recommends that the Australian Competition and Consumer Commission, or the proposed Australian Council for Competition Policy, establish a small team to make recommendations to the Treasurer every six months to improve competition in the banking sector.

4.2 If the relevant body does not have any recommendations in a given period, it should explain why it believes that no changes to current policy settings are required.

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1 Mr Rod Sims, Chairman of ACCC, *Committee Hansard*, 14 October 2016, p. 2.

2 Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard,* 14 October 2016, p. 5.

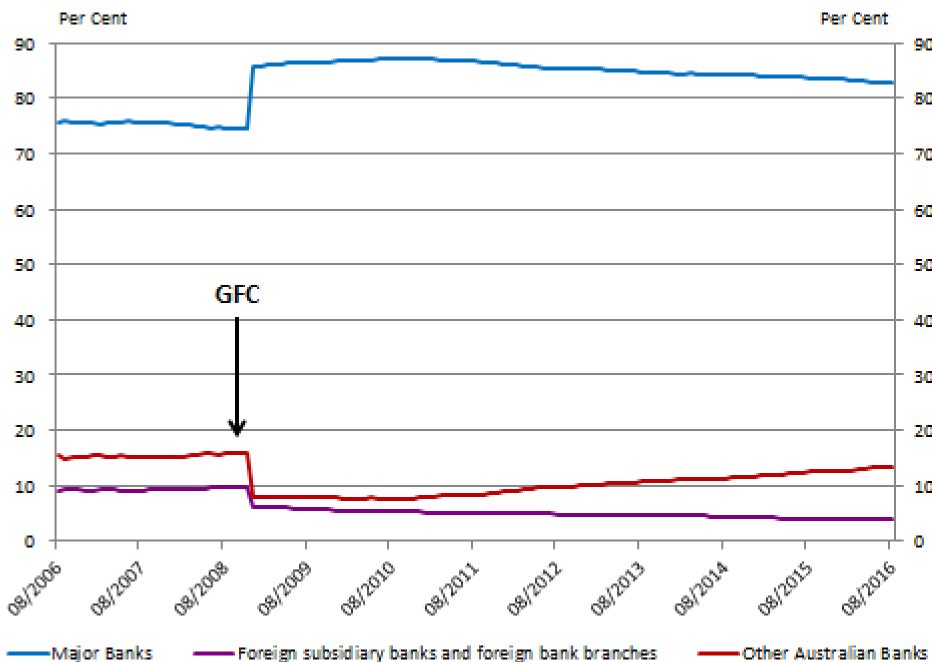
4.3 Oligopolies are problematic when they are able to use pricing power to the detriment of consumers.

4.4 Australia's banking system is such an oligopoly. Australia's four major banks have significant pricing power, higher than average returns on equity and large market shares.

4.5 This is particularly the case post-global financial crisis (GFC), due to:

- a significant degree of consolidation around 2008 as the major banks purchased a number of smaller competitors (Figure 4.1); and
- a collapse in securitisation markets, which had previously allowed the major banks' competitors to access cheap wholesale funding.

Figure 4.1 Market Shares of Bank Housing Lending



Source: APRA Monthly Banking Statistics (August 2016)

4.6 A lack of competition in Australia's banking sector has significant adverse consequences for the Australian economy and consumers.[3] It:

- creates issues around banks being perceived as too-big-to-fail (TBTF) (such as moral hazard);
- reduces incentives for the major banks to innovate and invest in new infrastructure; and
- can allow banks to use their pricing power to extract excess profits from consumers.

4.7 The committee finds it very surprising that no Australian government has completed a wholesale review of competition in the banking sector in recent times.

4.8 More surprising, however, is that despite the Australian Competition and Consumer Commission's (ACCC's) clear concerns about the level of banking competition, it has acknowledged not closely monitoring the sector because 'the RBA, APRA and ASIC are...observing the banks.'[4]

4.9 None of these regulators, however, have a clear mandate to promote competition in the financial sector. The ACCC does.

4.10 The Reserve Bank of Australia (RBA) are primarily concerned with financial stability; ASIC with ensuring market integrity and protecting consumers; and APRA with ensuring the financial soundness of prudentially regulated institutions.[5]

4.11 This means that no regulatory agency is regularly considering the level of competition in Australia's banking sector and whether change is required (Figure 4.2).

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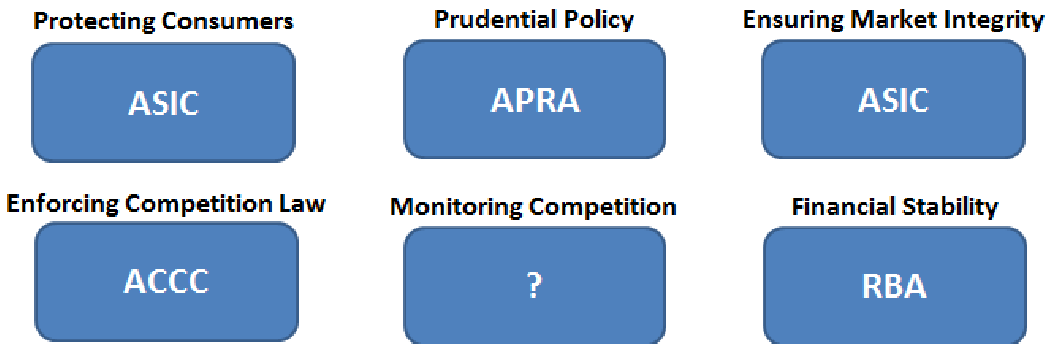
3 Mr Rod Sims, Chairman of ACCC, *Committee Hansard*, 14 October 2016, p. 16.

4 Mr Rod Sims, Chairman of ACCC, *Committee Hansard*, 14 October 2016, p. 3.

5 While APRA must balance the need for competition against its other mandated objectives, this is secondary to APRA's need to promote financial stability.

Figure 4.2 Regulatory oversight of the banking sector



4.12 The committee endorses the Government's decision to have the Productivity Commission periodically review financial sector competition. However, the committee does not believe that structural reviews undertaken 'as appropriate'[6] go far enough.

4.13 To create this accountability, the committee recommends that the ACCC (or the proposed Australian Council for Competition Policy (ACCP)) establish a small team dedicated to the continual monitoring of competition in the banking sector.

4.14 This team should make recommendations to improve competition in the banking sector to the Treasurer every six months.

4.15 Given repeated statements from the ACCC that the sector is uncompetitive, if the ACCC/ACCP does not make any recommendations for policy change in a given period, it should explain why that is appropriate.

4.16 Ongoing monitoring of the banking sector's competitiveness will fill an important gap in Australia's regulatory framework.

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6 Australian Government, *Attachment: Government response to Financial System Inquiry Recommendations*, <http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/Govt-response-to-the-FSI/html/08-Attachment>, viewed 20 October 2016.

4.17 In addition to filling a regulatory gap and improving the sector's accountability for its conduct and the pricing of interest rates and fees, the creation of this team would significantly enhance the ACCC's understanding of competition in the sector. This would better equip the ACCC to assess whether any potential future mergers or acquisitions are likely to significantly lessen competition.

4.18 This is of particular importance given that ASIC[7] and the ACCC[8] both advised the committee that prior mergers had lessened competition and that other competitors had not emerged as the ACCC had expected.

4.19 The committee does not imply that the ACCC acted inappropriately in its decision to not oppose many of these transactions. The committee is suggesting that enhancing the ACCC's understanding of competition in the sector on an ongoing basis should leave it better equipped to assess the effect of any future transactions.

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7 Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard*, 14 October 2016, pp. 21-22.

8 Mr Rod Sims, Chairman of ACCC, *Committee Hansard*, 14 October 2016, p. 14.

Pricing Power

4.20 One of the most powerful indicators of an oligopoly is pricing power.

4.21 The evidence suggests, and the ACCC Chairman agrees,[9] that the major banks' have significant pricing power. They have effectively lifted average interest rates across the economy; have passed increased costs on to consumers; and do not always compete aggressively for increased market share.

4.22 In the wake of the GFC, a comprehensive set of financial sector reforms have been progressed to improve ADIs' resilience. This includes increased capital and liquidity requirements, the introduction of a Net Stable Funding Ratio in 2018, and the development of a Loss Absorbing Capacity framework in line with international developments.

4.23 While these are necessary and critical reforms, they have come at a significant cost. In Australia this cost appears to have been borne largely by consumers.

4.24 There have been two clear recent examples of this.

4.25 Firstly, post-GFC, banks have been required to increase the share of their assets that are held in securities by around five per cent. The average return on these liquid assets is less than one per cent, which is significantly lower than the return on, for example, residential mortgages.[10]

4.26 In response to these lower rates of return, Australian ADIs have widened their lending spreads. This has forced consumers to bear the costs of holding these additional liquid securities, rather than shareholders.[11]

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9 M Roddan, 'Sims: ACCC 'covering most sectors', won't confirm banks', *The Australian*, 25 July 2016, <http://www.theaustralian.com.au/business/financial-services/sims-accc-covering-most-sectors-wont-confirm-banks/news-story/7201c237ed1362d861449e8bce29e511>, viewed 20 October 2016.

10 Dr Philip Lowe, Governor of the RBA, *Committee Hansard*, 22 September 2016, p. 7.

11 Dr Philip Lowe, Governor of the RBA, *Committee Hansard*, 22 September 2016, p. 8.

4.27 Secondly, in October 2015, the major banks announced out-of-cycle increases in mortgage standard variable rates (SVRs). This was attributed to APRA's interim work to implement the Financial System Inquiry's (FSI) recommendation that APRA:

> Raise the average internal ratings-based (IRB) mortgage risk weight to narrow the difference between average mortgage risk weights for authorised deposit-taking institutions using IRB risk-weight models [the major banks and Macquarie] and those using standardised risk weights [all other ADIs].[12]

4.28 APRA's changes to mortgage risk weights for banks using IRB models have increased the capital that the major banks have to hold against residential mortgages.

4.29 However, the magnitude of the interest rate increases in October 2015 (between 15 and 20 basis points for each of the major banks) indicates that the cost of higher capital requirements was borne largely by mortgage holders as opposed to shareholders.[13]

4.30 The major banks' pricing power is also observable in the fact that they closely follow one another's price changes, rather than attempting to increase their market share.

4.31 Since 2000, the spread between the interest rates charged on many retail and small business products and the cash rate has increased (Figure 4.3).

4.32 The committee understands that funding for these products comes from a range of sources, at costs that can differ widely from the cash rate.

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12 D. Murray et al., Financial System Inquiry, *Final Report*, 2014, p. 60.

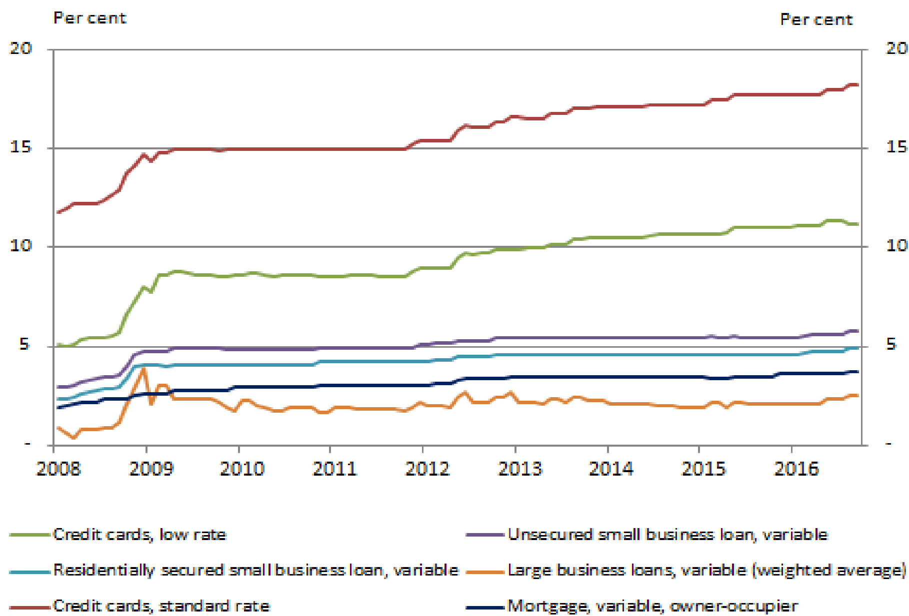
13 UBS, *Westpac Banking Corporation strengthens the balance sheet & reprices mortgages*, 2015, p. 1.

4.33 The committee also understands that these products can have differing levels of risk that may have been inaccurately priced pre-GFC (such as small business loans).

4.34 However, it is notable that post-GFC:

- spreads have increased on all consumer and small business products, including on low-rate credit cards - a product where providers ostensibly compete on price and not features;[14] and
- spreads have increased by less on lending to large businesses, that likely have access to a wider variety of non-ADI funding sources, than small businesses and retail customers.[15]

Figure 4.3 Consumer and business credit products' spread to cash rate



Source: RBA Indicator Lending Rates (September 2016)

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14 Mr Antony Cahill, Chief Operating Officer NAB, *Committee Hansard*, 6 October 2016, p. 25.

15 From January 1990 to August 2016, following the deregulation of the banking sector, this effect is more pronounced. The spread on loans to large businesses has declined by 20 basis points while the spread on SVRs, for example, has increased by 400 basis points.

4.35 This means that the gap between the cash rate and the interest rate on a broad range of consumer and small business products has become larger.

4.36 The major banks' pricing power is also observable in the net effect of their changes to mortgage SVRs that have been to consumers' relative benefit or detriment since 2000.

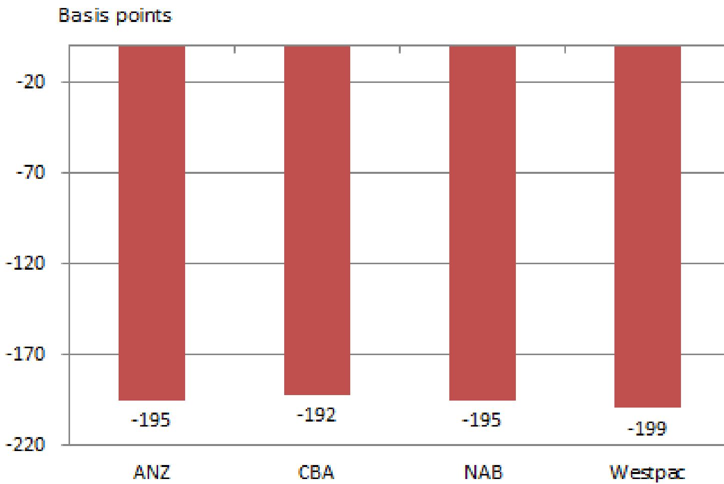
4.37 Mr Wayne Byres, APRA's Chairman, noted that in a competitive market, over the economic cycle, the net effect of these changes should be around zero.[16]This has not been the case in this century.

4.38 Since 2000, the major banks have made changes to their SVRs that have left mortgage holders with rates at least 195 basis points higher than they would be if the interest rate had simply tracked the cash rate (Figure 4.4).

4.39 In fact, since 2000, the major banks have averaged around one SVR change to consumers' relative benefit, compared to an average of around 19 SVR changes that have left consumers relatively worse off (Figure 4.5).

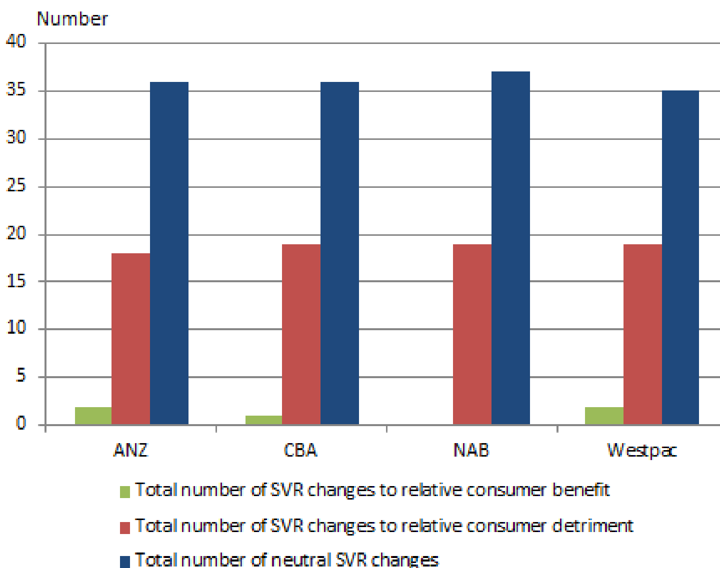
16 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 24.

Figure 4.4 Net consumer impact of major bank interest rate changes relative to RBA cash rate changes (2000 - 2016)



Source: RBA (October 2016), committee calculations.

Figure 4.5 Number of bank interest rate changes, by type, relative to RBA cash rate (2000 - 2016)

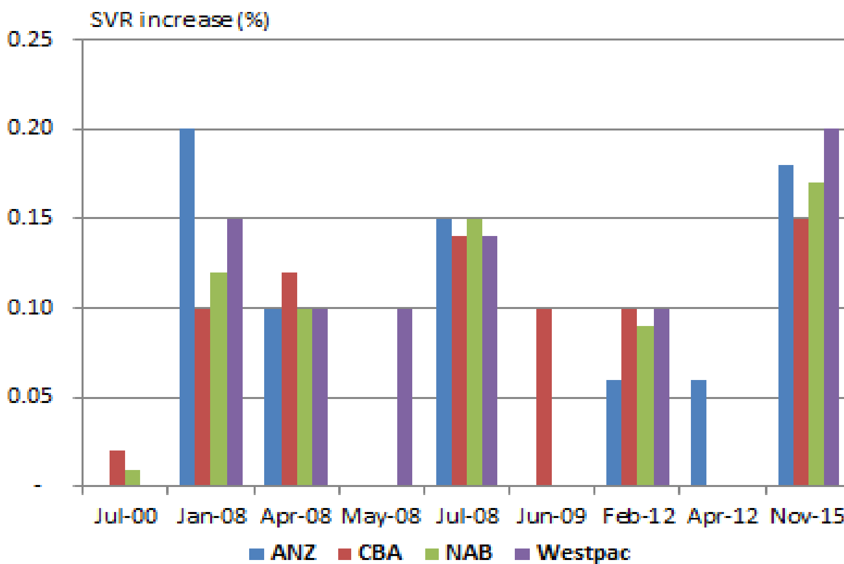


Source: RBA (October 2016), committee calculations

4.40 In addition to regularly using their pricing power, the major banks also tend to follow each other's price increases rather than compete to gain market share.

4.41 Since 2000, at least one of the major banks has increased their SVR out-of-cycle nine times. On five of these occasions, each of the other major banks has followed in the same month (Figure 4.6).

Figure 4.6 Major banks' out-of-cycle standard variable rate changes (2000 to current)



Source: RBA (October 2016)

Drivers of a lack of competition

4.42 The lack of competition in Australia's banking sector has a number of causes. These are primarily: the major banks' lower cost structures; the sector's high barriers to entry; and consumer inertia.

Cost Advantages

4.43 The funding and operating costs of the major banks are lower than their domestic competitors. Three important reasons for this are discussed below.

4.44 Firstly, the major banks are highly vertically and horizontally integrated, which provides them with significant economies of scale and scope.

4.45 Secondly, the market believes that the major banks are TBTF.

4.46 The credit rating agencies provide the major banks with a two-notch credit rating uplift due to a perceived implicit government guarantee, which effectively lowers their funding costs relative to other ADIs.

4.47 The RBA estimated that this implicit guarantee was worth as much as $3.7 billion to the major banks in 2013.[17]

4.48 Finally, the major banks (and Macquarie) use IRB models, as opposed to standardised models, to calculate their regulatory capital requirements.

4.49 IRB models allow banks to use sophisticated statistical techniques to determine what 'risk weights' to apply to their assets. These risk weights are used to calculate the value of the bank's 'risk weighted assets'.

4.50 In many cases, these models produce lower risk weighted asset values than the standardised model. This allows banks using IRB models to hold less capital against similar assets than banks using the standardised approach.

4.51 While APRA recently required ADIs using IRB models to increase residential mortgage risk weights to an average of at least 25 per cent, this is still substantially lower than the average risk weights that apply to ADIs using the standardised model (which can be up to 45 per cent).

4.52 APRA has calculated that the use of IRB models allows the major banks to cumulatively hold around $19 billion dollars less capital than if they were using the standardised model.[18]

4.53 The size of the major banks' funding cost advantage is shown in Figure 4.7.[19]

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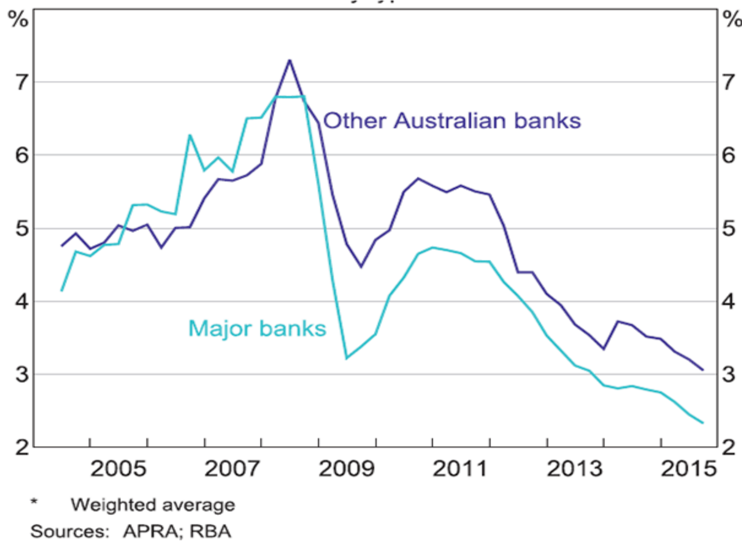
17 RBA, *Parliamentary Briefing, 24 February 2012 – Implicit Guarantees for Banks*, 2012, p. 44.

18 From 14 October 2016: APRA, *Response to a Question Taken on notice: Question Seven*, 1 November 2016.

19 Prior to the GFC, this funding cost gap was less pronounced due to mortgage lenders access to cheap funding through securitisation. As of 2015, issuance of Australian Residential Mortgage

Figure 4.7 Weighted average funding costs (per cent) for the major and other Australian banks



Source: RBA, Developments in Banks' Funding Costs and Lending Rates (2016)

4.54 The committee expects that, over time, the size of the major banks' cost advantages will decline due to:

- the Government's commitment to clarify and strengthen APRA's crisis management powers;
- APRA's commitment to introduce a domestic loss-absorbing capacity framework in line with international developments (both of which will reduce the perception that the major banks are TBTF);[20] and
- work by the Basel Committee on Banking Supervision (that APRA expects to adopt) to address excessive variability between the capital requirements for banks using IRB and standardised models.[21]

4.55 The committee strongly endorses these measures to improve competition.

Backed Securities was only around one-third of the level that it was at its peak. RBA, *Structural Features of Australian Residential Mortgage-backed Securities*, 2015.

20 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 18.

21 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 6.

High Barriers to Entry

4.56 Australia's banking sector has high barriers to entry. These arise for regulatory and commercial reasons.

- To operate as an ADI, institutions must obtain a banking license from APRA.

  Once licensed, ADIs must comply with APRA's prudential requirements on an ongoing basis.

- Under the *Financial Sector (Shareholdings) Act 1998* (FSSA), a shareholder or group of associated shareholders cannot hold more than 15 per cent of the prospective ADI's voting shares without an exemption.[22]
- Existing ADIs (particularly the major banks) hold significant amounts of consumer and business data that allows them to accurately model and price risk.[23]
- Existing ADIs (particularly the major banks) have strong brands and sophisticated distribution networks that are expensive to replicate.

4.57 The committee's findings and recommendations in relation to barriers to entry can be found in Section 6.

Consumer Inertia

4.58 Customer inertia also limits effective competition.

4.59 Despite efforts to reduce consumer switching costs over recent years, switching rates remain low. For example, only 46 customers approached

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22 There are reports that the FSSA is limiting bank start-ups where a small number of individuals necessarily hold the majority of the institutions shares.

23 The Productivity Commission recently noted that the data that banks hold 'provides some degree of competitive advantage for incumbents (Productivity Commission, *Data Availability and Use Draft Report*, November 2016, p. 545.)

ANZ using the government's formal switching process to change their bank accounts in September 2016.[24]

4.60 A critical factor behind these low switching rates is that switching costs are perceived to be high. This can leave customers unwilling to seek out better priced products from alternative providers.

4.61 Customer inertia is also encouraged by non-transparent pricing and product bundling.

- Non-transparent pricing (for example, fee-free accounts with costs recouped through overdrafts) make it difficult for consumers to identify whether an alternative provider's product is a better deal – both at a point-in-time and over the life of the product.
- Product bundling reduces customer switching by both decreasing price transparency and increasing switching costs (because to switch ADIs consumers would need to move multiple products).

4.62 The introduction of a 'tracker rate' mortgage (that is, mortgages that have an interest rate equal to the official cash rate plus a fixed margin) by AusWide Bank in October 2016 represents a notable response to some of these problems.

4.63 The committee welcomes the launch of this product. ASIC's Chairman, Mr Greg Medcraft, noted that, '[tracker rate mortgages] allow...true comparability and...true competition.'[25]

4.64 The committee believes that more needs to be done to empower consumers. The findings and recommendations in relation to these matters can be found in Section 5.

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24 ANZ Bank, *Response to Questions on Notice: Question Nine*,23 October 2016, p. 2.

25 Mr Greg Medcraft, Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 4.

The Australian Council for Competition Policy

4.65 The Competition Policy Review (the Harper Review) recommended that the Government dissolve the National Competition Council and establish the ACCP.[26]

4.66 The Harper Review recommended that the ACCP have a broad role encompassing:

- advocacy, education and promotion of collaboration in competition policy;
- independently monitoring progress in implementing agreed reforms and publicly reporting on progress annually;
- identifying potential areas of competition reform across all levels of government;
- making recommendations to governments on specific market design issues, regulatory reforms, procurement policies and proposed privatisations;
- undertaking research into competition policy developments in Australia and overseas; and
- ex-post evaluation of some merger decisions.[27]

4.67 The Government has endorsed the creation of the ACCP, however this requires the agreement of the states and territories.[28]

4.68 If the states and territories agree to the establishment of the ACCP and its proposed mandate, the Government should consider whether the ACCP or the ACCC would be the more appropriate body to regularly make recommendations to the Treasurer to improve competition in the banking sector.

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26 I. Harper et al., *The Competition Policy Review*, March 2015, p. 76.

27 I. Harper et al., *The Competition Policy Review*, March 2015, p. 77.

28 Australian Government, *Response to the Competition Policy Review,* 2015, p. 34.

5. Empower Consumers

> "We are strongly in favour of ensuring that consumers have better access to...data and that third parties can then use it to...offer services and identify opportunities" *Mr Peter Kell, Deputy Chairman of ASIC*[1]

> "We are supportive of a well-governed process of opening data up more. We are supportive of more competition; we think that it is healthy for customers and healthy for our industry as well" *Brian Harzter, CEO of Westpac*[2]

Recommendation 4

5.1 The committee recommends that Deposit Product Providers be forced to provide open access to customer and small business data by July 2018. ASIC should be required to develop a binding framework to facilitate this sharing of data, making use of Application Programming Interfaces (APIs) and ensuring that appropriate privacy safe guards are in place. Entities should also be required to publish the terms and conditions for each of their products in a standardised machine-readable format.

5.2 The Government should also amend the *Corporations Act 2001* to introduce penalties for non-compliance.

5.3 Enhancing access to publicly and privately held data has the potential to make a strong contribution to economic growth.

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1 Mr Peter Kell, Deputy Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 4.

2 Mr Brian Hartzer, CEO of Westpac, *Committee Hansard,* 6 October 2016, p. 41.

5.4 In 2013, the McKinsey Global Institute estimated that increasing access to data in consumer finance could add between $210 - $280 billion a year to global GDP,[3] with up to 50 per cent of this total flowing through to consumers through:

- enhanced price transparency;
- tailored product offerings; and
- consumers' ability to actively shape the products that they consume.[4]

5.5 Increased access to financial sector data, as noted by the Productivity Commission, should also intensify competition in the financial sector.[5]

5.6 This is because markets work best when customers are informed. At present banks, not consumers, hold the data. This gives banks a significant degree of power.

5.7 The UK's Competition and Markets Authority (CMA) recently found that both Small and Medium Enterprises and consumers find it difficult to understand the cost and quality of bank products and to compare the products that they have with products available from other providers.[6]

5.8 The CMA also found that up to 90 per cent of consumers could be around £92 (approximately $150AUD) better off each year by changing their current account.[7]

5.9 This is unsurprising. The cost of banking products is generally opaque, which increases switching costs for consumers and limits competition. Data sharing, however, can help to overcome these problems.

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3 McKinsey Global Institute, *Open Data: Unlocking innovation and performance with liquid information,* October 2013, p. 9.

4 McKinsey Global Institute, *Open Data: Unlocking innovation and performance with liquid information*, October 2013, p. 7.

5 Productivity Commission, *Data Availability and Use Draft Report*, November 2016, p. 553.

6 CMA, *Retail Banking Market Investigation Final Report,* 9 August 2016, p. XIV.

7 CMA, *Retail Banking Market Investigation Final Report,* 9 August 2016, p. XI.

5.10 For example, data sharing could increase price transparency with comparison services able to accurately assess how much a product would actually cost a consumer based on their usage and recommend the most appropriate products to them.

5.11 Increased price transparency will boost competition. As noted by the ACCC Chairman, Mr Rod Sims:

> ...consumers' ability to provide their data to alternative service providers will facilitate additional sources of competition in many markets. In many ways, data as an asset belonging to the consumer may well be the ultimate disrupter of concentrated markets. [8]

5.12 In addition to enhancing price transparency, the Financial System Inquiry (FSI) concluded that data sharing would 'better enable innovative business models.'[9] This could occur through the creation of products better tailored to individuals and by enabling, for example, rapid assessment of individuals' credit-worthiness.

5.13 The UK Government has recognised these benefits and has taken action.

5.14 The CMA will require banks to enable retail customers and small businesses to share their data securely with other banks and with authorised third parties using Application Programming Interfaces (APIs) by early 2018.

5.15 The committee believes that the Australian Government should amend the *Australian Securities and Investments Commission Act 2001* and, if required, the *Privacy Act 1998*, to empower ASIC to develop a data sharing framework for Australia's banking sector (with due consideration given to the need to protect individual's privacy and the confidentiality of their data).

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8 Sims, R. 'Data will give consumers upper hand', *The Australian Financial Review*, 9 November 2016, p. 43.

9 D. Murray et al., Financial System Inquiry, *Final Report*, 2014, p. 182.

5.16 In their appearance before the committee, each of the major bank's CEOs supported government action to facilitate greater data sharing in the banking sector (despite ANZ's,[10] CBA's,[11] and the ABA's[12]recent opposition to further government intervention). The Customer Owned Banking Association[13] and FinTech Australia[14] have also expressed support.

5.17 Sharing of consumers' and small businesses' data should be supplemented by the full release of standardised, machine-readable terms and conditions for each affected entity's full product suite. This is necessary to overcome the information asymmetry in the market.

5.18 To ensure that the banking sector meets its obligations, the committee also recommends that the Government amend the *Corporations Act 2001* to introduce penalties for non-compliance.

The benefits of data sharing

5.19 Data sharing allows authorised entities to transfer data, with consent, between each other using secure and encrypted connections.

5.20 Research by the Open Data Institute (ODI) and Fingleton Associates in the United Kingdom (UK) indicates that data sharing has a potentially significant role to play in overcoming many of the sector's structural limits on competition. Some of the potential benefits of data sharing are summarised in Table 5.1.

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10 ANZ, *Submission to Productivity Commission Issues Paper: Data Availability and Use,* 29 July 2016, p.12.

11 CBA, *Submission to the Productivity Commission Inquiry on Data Availability and Use*, July 2016, p. 2.

12 Productivity Commission, *Issues Paper: Data Availability and Use*, 29 July 2016, p. 2.

13 Customer Owned Banking Association, *Productivity Commission Inquiry on Data Availability and Use*, July 2016, p. 2.

14 FinTech Australia, *Productivity Commission Inquiry into Data Availability and Use: Open Financial Data*, July 2016, p. 3.

Table 5.1 The potential benefits of data sharing and open data sets

Structural Problem	Example of problem	Role for data sharing
High barriers to entry	The large data sets that major banks hold on individual customers and in aggregate allows them to better assess risk and price loans.	If other ADIs and alternative lenders were able to access all lending and credit data, firms could then better compete on their ability to assess and price risk.
Opaque pricing	Transaction accounts, credit cards and other loans are priced as a blend of charges, foregone interest/interest and penalties. This makes it hard for consumers to compare products.	If a customer's actual usage data was available, comparison websites could tell customers precisely how much they paid for their account in the previous year. If data on banks' products was also made open access, such comparison services could point users towards the cheapest product based on their historical usage.
Consumer Inertia	A lack of transparent pricing coupled with the difficulty of transferring payments can make account holders reluctant to change banks.	More transparent pricing reduces the information costs of switching. Open access data on debits may make it easier to transfer them to new providers.

Source: ODI and Fingleton Associates, Data Sharing and Open Data for Banks, 2014, p. 12.

5.21 In addition to improving competition, better data sharing should also increase economic efficiency. For example, data sharing should drastically reduce data entry costs for businesses and consumers.[15]

What data should be made available?

5.22 Generally the greater volume of data shared, the greater the potential benefits. However, for technical, legal, cost and regulatory reasons it is not appropriate to make all data sets accessible.

5.23 The committee believes that there is a strong case for increasing access to, what the banks themselves regard as, customers' data.[16]This includes, for example, a customer's transaction history, account balances, credit card usage, and mortgage repayments.

5.24 This data is critical to overcoming the problems of consumer inertia and opaque pricing that exist in the banking sector. However, the sharing of consumers' data is not sufficient on its own.

5.25 To maximise the data's usefulness, the committee believes that each data-sharing participant should also release the terms and conditions for each of their banking products in a standardised and machine-readable format.

5.26 These two data sets are critical to the development of products tailored to individual consumers as well as better aggregators that can offer personalised advice to consumers.

How should data be made available?

5.27 Data sharing arrangements and open data sets can take a number of forms. The Government's role is to set rules, templates, and access requirements to ensure that data can be accessed and manipulated efficiently with adequate privacy and data protection safeguards.

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15 Productivity Commission, *Data Availability and Use Draft Report*, November 2016, p. 553.

16 Mr Antony Cahill, Chief Operating Officer of NAB, *Committee Hansard*, 6 October 2016, p. 33; Mr Shayne Elliott, CEO of ANZ, *Committee Hansard,* 5 October 2016, p. 6.

5.28 In order to reap the potential benefits, any data sharing framework must have the following characteristics:[17]

- data should be available to all licensed users;
- data should be able to be processed automatically (that is, data should be machine readable); and
- data should be accessible at no or negligible cost on an ongoing basis.

5.29 There are four common ways to facilitate data sharing. Their pros and cons are detailed in Table 5.2.

Table 5.2 Sample pros and cons of different data sharing methods

Method	Description	Pros	Cons
APIs	APIs are standards that allow software components to interact and exchange data.	Provides up to date data that is easy to read and process. Can be automated. Only read-access is provided. Access can be restricted to certain data sets and types. Access can be restricted to authorised users. Does not require log in credentials to be shared.	Of the options listed, APIs are the most expensive to establish. Access to API data would have to be regulated.

17 McKinsey Global Institute, *Open Data: Unlocking innovation and performance with liquid information*, October 2013, p. 3.

Method	Description	Pros	Cons
Comma Separated Values (CSV) files	CSV files are a standard file-type that can be read by a wide range of programmes.	Easy and cheap to produce. Easy to read and process.	Files are a 'point in time' measure which limits ongoing usability. Can be user-manipulated.
'Screen Scraping'	Screen scraping involves consumers providing firms with their log-on credentials so that they can retrieve up-to-date data from users' service providers using algorithms.	Provides up to date data that is easy to read and process. Can be automated.	Can be difficult to establish, limiting usability. Scrapers breach banks' terms and conditions. The credentials provided to screen scrapers can be used to 'read and write'. No restrictions on use.
Manual file handling	Manual entry of printed documentation.	Simple. Impact of hardware failure is limited.	Inefficient to process. Files are a 'point in time' measure which limits ongoing usability. Human errors are likely.

Source: Data Sharing and Open Data for Banks, 2014, p. 22.

5.30 It is clear to the committee that APIs present the largest number of benefits in terms of data security, data credibility and accessibility.

5.31 APIs will, however, require meaningful upfront investment.

5.32 Despite the associated costs, the UK Government has endorsed the establishment of an open API standard in the UK's banking sector to commence in 2018.

5.33 The committee similarly recommends that the Government require ASIC to develop a binding framework to facilitate the sharing of customers' and small businesses' data between Deposit Product Providers and relevant third parties (as deemed appropriate by ASIC) through APIs by July 2018.

5.34 The committee disagrees with the Productivity Commission's view in its draft report on data availability and use that CSV files (or similar) should be used to share financial sector data at this time.

5.35 This is because the data reported in CSV files must be standardised to support machine readability before the scheme can commence. This severely curtails the framework's ability to support innovation and competition. The Productivity Commission note that:

> The substantive argument in favour of making data more available is that opportunities to use it are largely unknown until the data sources themselves are better known, and until data users have been able to undertake discovery of data.[18]

[18] Productivity Commission, *Data Access and Availability Draft Report*, November 2016, p. 2.

5.36 The Productivity Commission's proposal for data sharing in the financial sector fails this test. The committee is further disinclined to support the use of CSV files because:

- the need to standardise the data in CSV files means that their contents could not rapidly change in response to the market's changing data needs;
- CSV files are point-in-time and subject to manipulation;[19] and
- using CSV files is more complex than using APIs, increasing transaction costs for consumers and service providers.[20]

5.37 The committee also disagrees with the Productivity Commission's preliminary view that implementing APIs would be prohibitively expensive. This is for two reasons:

- while detailed modelling has not been completed in Australia, the ODI has estimated that establishing an API framework (from scratch) would cost around £1 million per institution in the UK;[21] and
- given the detailed work that has already gone into the development of a data sharing framework for the UK, Australia has the opportunity to learn from this process, rather than seek to create an entirely new domestic system from the ground up.

19 *Data Availability and Use Draft Report*, November 2016, p. 555.

20 For example, using CSV files for comparison services would require users to download the relevant file from their ADI and upload it to the service provider and service providers must then verify the file. APIs remove the need for these processes.

21 Converted from the £1 million per institution calculated by ODI on 2 November 2016: ODI and Fingleton Associates, *Data Sharing and Open Data for Banks*, 2014, p. 87.

Recommendation 5

5.38 The committee recommends that the Government, following the introduction of the New Payments Platform, consider whether additional account switching tools are required to improve competition in the banking sector.

5.39 Enhanced data sharing and increased price transparency are of little value if it is difficult for consumers to change product providers. Knowing that a better deal exists is worthless if it is too hard to take advantage of.

5.40 If it is difficult for consumers to switch, the competitive impact of data sharing will be muted. As noted by APRA's Chairman:

> Efforts to improve the capacity of customers to be able to switch between financial institutions is important because, if there are barriers to customers switching, it obviously lessens the competitive instinct and the desire for organisations to look after their customers.[22]

5.41 It is therefore critical that efforts to enhance data sharing are accompanied by measures to reduce switching costs. Switching costs, whether they are high or just perceived to be high, can present a significant barrier to competition.

5.42 In 2011, the previous Government made a number of policy changes to improve competition in the banking system. This included measures to reduce switching costs.

5.43 Since 1 July 2012, when consumers establish a new bank account they have been able to sign a form that requires their new financial institution to transfer regular direct debits and credits from their old financial institution to their new account.

5.44 However, the service cannot be used to switch regular BPAY transactions, 'internet pay-anyone' transactions, or payments to and from debit and credit cards.

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22 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 16.

5.45 Further, despite its significant limitations the process can take up to two weeks to complete.[23] In 2016, this is unacceptable.

5.46 Given that transferring payments from one account to another is one of the most significant barriers to switching, it is clear that existing switching tools have failed. This is evidenced by the fact that, as outlined in section three, only 46 customers approached ANZ using the government's formal switching process to change their bank accounts in September 2016.[24]

5.47 In light of the system's severe flaws, a number of ADIs have developed their own switching services.

5.48 These switching services are more common among larger and more sophisticated institutions and their existence may actually limit competition by steering consumers towards the largest ADIs by default.

5.49 It is clear that there is a role for government in reducing switching costs for all consumers – not just those switching to Australia's largest banks – to improve competition.

5.50 The committee is therefore heartened by the planned introduction of the New Payments Platform (NPP) in the second half of 2017.

5.51 The NPP should spur competition in the sector by simplifying the process for switching payments from one account to another (Figure 5.1).[25]

5.52 This is because payments will no longer have to be routed to or from a combination of a Bank-State-Branch (BSB) and account numbers, but instead to an individual's phone number or email address that would be linked to the relevant bank account.

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23 ME Bank, *The Hands-free Switch,*<https://www.mebank.com.au/personal/bank-accounts/switch/the-handsfree-switch/>, viewed 19 October 2016.

24 ANZ Bank, *Response to Questions on Notice: Question Nine,*23 October 2016, p. 2.

25 Dr Philip Lowe, Governor of the RBA, *Committee Hansard*, 22 September 2016, pp. 25-26.

5.53 In this world, as noted by the RBA Governor, shifting a customer's regular outgoing and incoming payments will be as simple as changing the relevant link.

> One of the traditional issues for customers has been not necessarily moving bank accounts but is in relation to direct debits or credits going into and out of that particular account. The new payments platform will provide all Australian consumers with an alias ID—they can use their mobile phone number or an email address—and they can associate that alias ID with their bank account. So...you would be able to go to the new payments platform and go to your alias ID and change your account number. [26]

5.54 The NPP is not the only way to achieve this outcome. Full bank account portability would also dramatically simplify the process of re-directing payments as part of the switching process.[27]

5.55 However, introducing full bank account portability would be expensive. This is because:

> It [full account portability] would involve the replacement of the bank, state, branch (BSB) system of numbering, and wholesale revamping of the existing payments infrastructure and the systems of all the financial institutions which interface with it.[28]

5.56 While these costs have not been determined in Australia, the CMA has estimated that introducing full account portability in the UK would cost at least £2-£3 billion (around $3-$5 billion AUD).[29]

5.57 It is not clear that this expense is justified prior to the introduction and reviews of the NPP's effectiveness in 2017.

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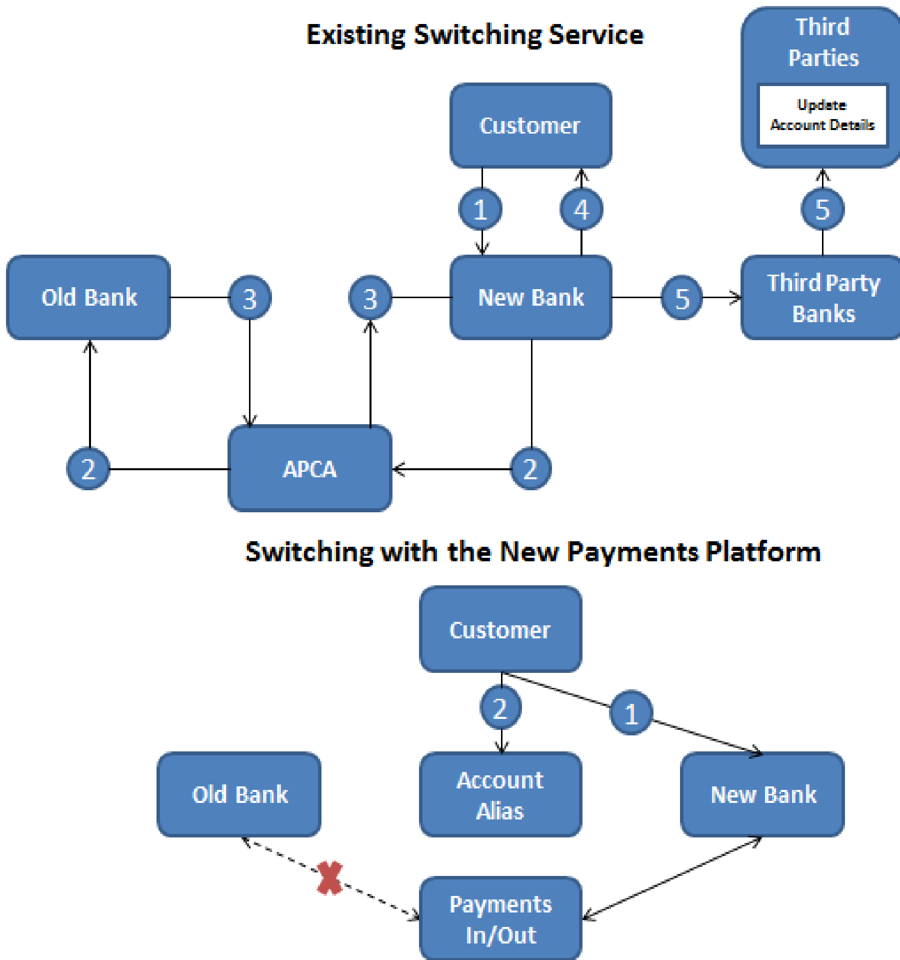
26 Mr Antony Cahill, Chief Operating Officer of NAB, *Committee Hansard*, 6 October 2016, p. 7.

27 CMA, *Retail banking market investigation Final report*, 9 August 2016, p. 502.

28 B. Fraser, *Bank Services Switching Arrangements*, August 2011, p. 7.

29 CMA, *Retail banking market investigation Final report*, 9 August 2016, p. 515.

Figure 5.1 Redirecting payments – existing switching service compared to the New Payments Platform



Source: Banking Services Switching Arrangements, August 2011, p. 14, Committee Hansard, 22 September 2016, pp. 25-26. Note: APCA is the Australian Payments Clearing Association. It is a self-regulatory body that intermediates the redirection of payments between a consumer's old and new ADI.

5.58 While the NPP will increase consumers' power, it is too early to judge whether it will be enough to increase competition on its own. For example, the NPP may be of limited use to a customer with a number of different products (such as transaction accounts and credit products) to switch.

5.59 The committee therefore recommends that the Government, following the introduction of the NPP, consider whether additional measures to simplify switching are required to improve competition in the banking sector.

5.60 The committee notes that Bacs' work to improve the UK's Current Account Switching Service (due end-2017) may have findings relevant to Australia. [30]

30 Bacs is responsible for clearing and settling automated payments in the UK.

6. Make it Easier for New Banking Entrants

"Inevitably competition comes from the new entrants. It is not likely that all of a sudden existing incumbents will decide to compete a whole lot more aggressively" *Dr Philip Lowe, Governor of the RBA*[1]

Recommendation 6

6.1 The committee recommends that by the end of 2017:

- **the Government review the 15 per cent threshold for substantial shareholders in Authorised Deposit-taking Institutions (ADIs) imposed by the *Financial Sector (Shareholdings) Act 1998* to determine if it poses an undue barrier to entry;**

- **the Council of Financial Regulators review the licensing requirements for ADIs to determine whether they present an undue barrier to entry and whether the adoption of a formal 'two-phase' licensing process for prospective applicants would improve competition; and**

- **APRA improve the transparency of its processes in assessing and granting a banking licence.**

[1] Dr Phillip Lowe, Governor of the RBA, *Committee Hansard*, 22 September 2016, p. 28.

6.2 Australia's banking sector has high barriers to entry. While the last decade has seen a number of foreign bank branches and foreign bank subsidiaries become ADIs, the situation for new domestic competitors is very different.

6.3 In the last decade only one entity that was not associated with an existing bank has been granted a new banking license.[2]This suggests that Australia's start-up banking sector is effectively non-existent.

6.4 Oligopolies may maintain their dominant position in a market when it is too costly or difficult for potential rivals to enter. These barriers can be considered to be either commercial or regulatory in nature.

6.5 Commercial barriers to entering Australia's banking sector include:

- economies of scale and scope;
- large information costs; and
- sophisticated distribution networks.

6.6 Regulatory barriers to entering Australia's banking sector include:

- the need to obtain a banking license from APRA (or a relevant licence from ASIC);
- the *Financial Sector (Shareholdings) Act 1998* (FSSA), which limits individual's shareholdings in ADIs and insurance companies; and
- ongoing compliance with regulatory and legislative requirements.

6.7 The committee does not believe that it is the government's role to remove legitimate commercial barriers to entry. In a market economy it is up to prospective entrants to offer products and operate a business model that can overcome these challenges.

6.8 The committee does believe, however, that government and regulators should periodically assess the regulatory barriers that are in place to consider whether they remain appropriate.

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2 According to APRA there have been 29 new ADIs licensed in Australia since 2006 including foreign bank branches and subsidiaries of foreign banks.

6.9 This is particularly important in a regulatory environment where the FSI noted that 'there is complacency about competition' and there are limited structures in place to 'systematically identify and address competition trade-offs in regulatory settings.'[3]

6.10 This is especially problematic during periods when innovative new business models are emerging, such as the growth in FinTech firms today. The Productivity Commission has concluded that prescriptively enforcing existing regulations in the wake of such models 'could lead to poor regulatory outcomes that stifle innovation.'[4]

6.11 While the committee welcomes the Government's decision to include competition in ASIC's mandate and to seek detailed information from APRA, ASIC and the Payments System Board on how they have balanced competition with other elements of their mandate in their annual reports, these are forward looking measures. These measures will not result in the formal assessment of existing regulatory structures to determine whether they are inappropriately limiting competition.

6.12 To fill this gap in the reform agenda, the committee recommends that the Government and regulators, with due consideration given to the maintenance of high prudential standards and financial stability, undertake a comprehensive review of:

- the 15 per cent threshold for substantial shareholders in ADIs under the FSSA;
- the licensing requirements for ADIs to determine whether they present an undue barrier to entry and whether a formal 'two-phase' process for licensing prospective applicants (similar to that in place in the UK) would boost competition; and
- whether APRA's processes in assessing and granting a banking licence could be made more transparent.

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3 D. Murray et al., Financial System Inquiry, *Final Report*, 2014, p. 237.

4 Productivity Commission, *New Business Models and Regulation*, December 2015, p. 211.

6.13 These measures would supplement ASIC's existing work to support new entrants. This includes the establishment of an 'Innovation Hub' and a 'Regulatory Sandbox', which will allow start-ups to test certain financial services for six months without a licence.

6.14 Given expected growth in the use of FinTech services over the next year (up to 150 per cent according to UBS)[5]and the potential for such firms to effectively disrupt traditional banking business such as payments, foreign exchange and remittance services, these are critical steps.

6.15 The committee does not believe, however, that they are enough on their own to sustain a culture of innovation and competition in Australia's banking and financial sector.

6.16 The creation of such a culture is necessary to improve consumer outcomes. This is because the committee expects that start-up firms will emerge with business models that effectively disrupt the status quo. For example, competition in Australia's mortgage market in the 1990s largely emerged due to a new group of firms taking advantage of securitisation markets to obtain cheap funding – not the entry of foreign banks.

6.17 It is start-ups' ability to 're-make the playing field' that makes them so critical to improving the competitiveness of Australia's banking sector.

Regulatory barriers to entry

6.18 A strong and stable banking sector is central to Australia's ongoing economic prosperity. Regulatory barriers to entering the sector are critical to achieving this.

6.19 Stability and competition in the banking sector can be seen as conflicting objectives. However, as noted by the Chairs of both APRA[6] and the ACCC,[7] this does not have to be the case.

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5 UBS, *Global banks: Is FinTech a threat or an opportunity?*, 26 July 2016, p. 1.

6 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 2.

7 Mr Rod Sims, Chairman of ACCC, *Committee Hansard*, 14 October 2016, p. 2.

6.20 Reducing barriers to entry as much as prudently possible should help spur a more competitive, contestable and innovative banking sector.

Obtaining a Banking License

6.21 To operate as an ADI, institutions must obtain a banking license from APRA. This process can take several years and anecdotal evidence suggests that 'APRA may take a more rigorous approach to licensing new ADIs and insurers, relative to some other jurisdictions.'[8]

6.22 To obtain a banking license, applicants must satisfy APRA that they are able to comply with capital adequacy and other prudential requirements from the date that their operations commence and on an ongoing basis.

6.23 To operate as a bank, prospective applicants require at least $50 million in Tier 1 Capital (generally common equity). There is no set minimum capital amount for other ADIs (such as credit unions and building societies), but APRA must deem it to be adequate.[9] Foreign ADIs are not required to maintain capital endowed in Australia.

6.24 On an ongoing basis, ADIs must hold regulatory capital equal to at least eight per cent of total risk weighted assets (however new ADIs can be subject to higher minimum capital requirements in their formative years)[10] and also comply with various liquidity, governance, risk management, information technology and audit requirements.

6.25 These ongoing requirements are prudent and necessary. There is evidence to suggest, however, that simplifications to the initial licensing process can have a significant effect on the number of market entrants and competition.

6.26 In 2014, in response to a report by the UK's Parliamentary Commission on Banking Standards, the UK's Prudential Regulation Authority (PRA) made a number of changes to its licensing process. This included:

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8 APRA, *Financial System Inquiry: Response to the Interim Report*, 26 August 2014, p. 82.

9 APRA, *ADI Authorisation Guidelines*, August 2008, p. 6.

10 APRA, *ADI Authorisation Guidelines*, August 2008, p. 6.

- a reduction in capital requirements for new entrants to a minimum of £1 million (down from £5 million); and
- the introduction of a two-phase licensing process that allows new entrants to obtain a 'restricted license', after which they have a year to raise required capital, hire staff, and invest in technology systems.
  - In his appearance before the committee, APRA's Chairman noted that APRA have an 'iterative process' to granting banking licenses. However, this process is not as transparent as the UK's regime.

6.27 In announcing these changes, Mr Andrew Bailey, the former Chief Executive of the PRA, stated that:

> Reducing barriers to entry can be achieved alongside continuing to ensure new banks meet basic standards that prevent risks to the safety and soundness of the UK financial system.[11]

6.28 These measures have since been further enhanced.

6.29 In January 2016, the PRA established a bank start-up unit (jointly run with the Financial Conduct Authority (FCA)) to give information and support to newly authorised banks as well as prospective applicants. These reforms have greatly improved the transparency of the UK's licensing process.

6.30 These measures have been very successful. Fourteen new banks have been approved in the UK since 2014. As of July 2016, a further 20 entities were reportedly in talks with the PRA in regards to obtaining a license.[12]

6.31 This sits in stark contrast to the one new ADI licensed in Australia in the last decade that was not a foreign subsidiary or a branch of a foreign bank.

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11 Bank of England, *News Release – Prudential Regulation Authority and Financial Conduct Authority publish review of barriers to entry for new banks,* 7 July 2014, <http://www.bankofengland.co.uk/publications/Pages/news/2014/098.aspx>, viewed 22 October 2016).

12 T. Wallace, 'Twenty more banks want a license in flood of new competition', *The Telegraph,* 3 July 2016, <http://www.telegraph.co.uk/business/2016/07/03/twenty-more-banks-want-a-licence-in-flood-of-new-competition/>, viewed 22 October 2016.

The Financial Sector (Shareholdings) Act 1998

6.32 In addition to APRA's licensing requirements, the FSSA can pose a barrier to entering Australia's banking sector.

6.33 Ownership in locally incorporated ADIs, including foreign bank subsidiaries, is governed by the FSSA.

6.34 Under the FSSA, all substantial shareholders of an applicant are required to demonstrate that they are well-established, financially sound entities of standing and substance. Applicants must also demonstrate that their involvement with the prospective ADI will be a long-term commitment and that they have the means to contribute additional capital to the bank, if required.

6.35 The FSSA limits shareholdings of an individual shareholder, or group of associated shareholders, in an ADI to 15 per cent of the ADI's voting shares, unless an exemption has been granted by the Treasurer or APRA (with or without conditions).[13]This limit has not been changed since the FSSA was introduced.

6.36 The FSSA gives the Treasurer an important tool to restrict investment.

6.37 This is particularly the case since changes to the *Foreign Acquisitions and Takeovers Act 1975* in 2015 that removed the requirement for foreign investment proposals to be considered under that Act where they would also be considered under the FSSA (subject to a few exceptions).

6.38 Often prospective ADIs (particularly start-ups, given their limited pool of owners) will need to obtain an FSSA exemption. Exemptions are granted as long as additional shareholdings are not found to be contrary to the national interest.

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[13] APRA has been delegated responsibility for signing off on FSSA exemptions for ADIs with less than $1 billion in resident assets.

6.39 As in similar legislation governing significant investment, 'national interest' is not defined. However, the government does provide a list of potentially relevant factors. These include:

- national security;
- competition;
- impact on the economy and community; and
- the character of the investor.[14]

6.40 Start-up ADIs are unlikely to be barred under the FSSA on national security or competition grounds. However, one of APRA's key considerations in assessing an exemption relates to the ability of a prospective ADI's owners to provide capital to the ADI during periods of financial stress.[15]

6.41 In practice, FSSA requirements are therefore likely to work against prospective start-up ADIs without diversified ownership because individuals or families are unlikely to have sufficient resources to re-capitalise the ADI, if required. While there is clearly a logic to this approach, it is important that the FSSA requirements do not unduly limit the establishment of new ADIs.

6.42 Given it has been 18 years since the FSSA was introduced, a transparent assessment of the ongoing appropriateness of the FSSA is in the national interest.

14 Australian Government, *Australia's Foreign Investment Policy*, December 2015, p. 7.

15 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 6.

7. Force Independent Reviews of Risk Management Systems

"When did I personally become aware of it?...As a result of the attention that it got earlier this year" *Mr Ian Narev, CEO of the Commonwealth Bank, on how Four Corners alerted him to CommInsure's alleged mishandling of claims*[1]

"We made a mistake. It was poorly managed. We did not have the right controls and processes in place" *Mr Shayne Elliott, CEO of the Australia and New Zealand Bank on the incorrect allocations of funds between 1,400 superannuation accounts for up to 12 months*[2]

Recommendation 7

7.1 The committee recommends that the major banks be required to engage an independent third party to undertake a full review of their risk management frameworks and make recommendations aimed at improving how the banks identify and respond to misconduct. These reviews should be completed by July 2017 and reported to ASIC, with the major banks to have implemented their recommendations by 31 December 2017.

1 Mr Ian Narev, CEO of the CBA, *Committee Hansard*, 4 October 2016, p. 19.

2 Mr Shayne Elliott, CEO of the ANZ, *Committee Hansard*, 5 October 2016, p. 3.

7.2 Effective risk management and mitigation is central to protecting consumers and other stakeholders from problems before they have the chance to arise or become endemic.

7.3 Over the last two decades Australia's major banks have demonstrated that they have robust, forward looking, financial risk management frameworks.[3]

7.4 It is disappointing that the committee cannot say the same of the frameworks that are in place to manage risks that threaten consumers.

7.5 The processes that the major banks have in place to protect consumers seem to be reactive, rather than proactive. APRA's Chairman, Mr Wayne Byres, agreed with this conclusion. He noted that:

> I think there has rightly been a lot of attention in the banking industry given to financial risks...There has probably not been the attention given to the soft stuff – to cultural issues and the impacts that they can have...[4]

7.6 For example, on numerous occasions bank CEOs only became aware of issues of serious misconduct and operational failings after – in some cases – thousands of consumers had been negatively affected. For example:

- the collection of around $178 million in financial advice fees for which no financial advice was provided;
- the provision of poor financial advice at NAB[5] (which has since resulted in more than $21 million in compensation);
- OnePath (ANZ's wealth management arm) charging more than 400,000 customers inappropriate fees on four occasions since 2015;[6]
- NAB incorrectly calculating returns for around 62,000 wealth management customers (for which it has had to refund $25 million);

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3 For example: Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 21.

4 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 9.

5 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 10.

6 Mr Shayne Elliott, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 5.

- Westpac incorrectly collecting $29.2 million in fees from account holders and credit card customers;[7]
- Westpac failing to identify 11 financial planners guilty of misconduct;[8] and
- Capital Finance Australia (a Westpac subsidiary) breaching important consumer protection provisions in the *National Consumer Credit Protection Act 2009* 58 times during three months in 2015.

7.7 As further evidence, there are a number of cases where CEOs only became aware of issues of serious misconduct after external parties brought it to their attention. For example:

- Mr Narev, CEO of the CBA, was unaware of poor claims handling practices at CommInsure prior to the ABC and Fairfax investigation;
- CBA was unaware of serious misconduct – including fraud – in its financial planning division prior to a whistle-blower going public in 2013; and
- Mr Elliott, CEO of the ANZ, would arguably still be unaware of highly unethical behaviour within his bank's institutional division had ASIC not commenced an investigation into that division of the bank.[9]

7.8 It is unacceptable that, in the case of CBA (and ostensibly other institutions), existing 'quality assurance systems ...failed to identify patterns of bad behaviour.' [10]

7.9 The committee is pleased to hear that each of the major banks has increased investment in the systems that they use to identify misconduct.[11]APRA's Chairman noted that:

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7 Mr Brian Hartzer, CEO of Westpac, *Committee Hansard*, 6 October 2016, pp. 44-45.

8 Mr Brian Hartzer, CEO of Westpac, *Committee Hansard,* 6 October 2016, p. 57.

9 Mr Shayne Elliott, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 15.

10 CBA, *Submission Senate Economics References Committee: Inquiry into the scrutiny of financial advice*, December 2014, p. 5.

11 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 10; Mr Ian Narev, CEO of CBA, *Committee Hansard,* 4 October 2016, p. 2; Mr Brian Harzter, CEO of Westpac,

> They [the banks] are looking harder for instances where things have gone wrong and people have been mistreated...to the extent that they are finding them...I think that is a cleansing of past issues.[12]

7.10 However, in most cases these changes appear to have been ad hoc and in response to known failures. They have been reactive.

7.11 From the testimony provided, it is not clear that all of the major banks have completely reviewed the processes that they have in place to protect consumers, despite the numerous observable failure of these systems. [13]

7.12 Even in cases where reviews have been undertaken, given that 'approaches to understand and manage risk culture are at a relatively early stage of development [within prudentially regulated institutions]'[14] and that demonstrable links exist between poor risk culture and the potential for poor consumer outcomes, the committee believes that further reviews are required.

7.13 For this reason, the committee recommends that each of the major banks be required to engage an independent third party to undertake a full review of their risk management frameworks and make recommendations aimed at improving how the banks identify and respond to misconduct. These reviews should focus on:

- the development of a proactive framework to identify and manage risks to consumers;
- the creation of an 'early alert' system, similar to those used in other industries, to ensure that relevant executives are informed of emerging problems;

Committee Hansard, 6 October 2016, p. 41; Mr Shayne Elliott; CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 15.

12 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 10.

13 Mr Hartzer's evidence suggests that Westpac has reviewed all of its processes to enable Westpac to identify risks – including conduct risks – on a more proactive basis.

14 APRA, *Information Paper: Risk Culture*, October 2016, p. 14.

- the merits of a 'product recall' tool that can be triggered in response to a range of fixed criteria, to supplement ASIC's proposed product intervention and banning power; and
- the appropriateness of existing training on, and frameworks to support, whistle-blowers and whistle-blower protections.

7.14 As noted by APRA's Chairman, improving the major banks' ability to detect and respond to risks to consumers is critical because:

> ...it [culture and compliance frameworks] is essential to long-run financial health and long-term community trust in the financial system. The financial system – banking in particular – is a business of trust. If you lose that trust, you lose your franchise.[15]

7.15 The outcome of these reviews should be submitted to ASIC. This will also allow ASIC to monitor the implementation of their recommendations.

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15 Mr Wayne Byres, Chairman of APRA, *Committee Hansard*, 14 October 2016, p. 9.

8. Improve Internal Dispute Resolution Schemes

> "IDR appears to be broken – one talks to different members of staff every time one calls; emails go unanswered, letters from us claiming breach of responsible lending have been treated as requests for hardship" *Joint Consumer Group submission to the Review of the Financial System Dispute Resolution Framework*[1]

Recommendation 8

8.1 The committee recommends that the Government amend relevant legislation to give the Australian Securities and Investments Commission (ASIC) the power to collect recurring data about Australian Financial Services licensees' Internal Dispute Resolution (IDR) schemes to:

- **enable ASIC to identify institutions that may not be complying with IDR scheme requirements and take action where appropriate; and**
- **enable ASIC to determine whether changes are required to its existing IDR scheme requirements.**

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1 Care Inc et al., *Submission to Review of the Financial System Dispute Resolution Framework – Issues Paper*, 10 October 2016, p. 26.

8.2 The committee further recommends that ASIC respond to all alleged breaches of IDR scheme requirements and notify complainants of any action taken, and if action was not taken, why that was appropriate.

8.3 Even with appropriate internal governance and risk management processes in place, there will always be situations in which disputes arise.

8.4 Therefore it is critical that internal dispute resolution (IDR) schemes are properly designed and adequately resourced to ensure that any disputes with consumers or small businesses are resolved effectively.

8.5 Complainants must attempt to resolve disputes through a licensees' IDR scheme before their complaints can be considered by an EDR scheme. IDR is an important first step in the disputes handling process because:

- it gives product providers the opportunity to address consumer concerns efficiently and effectively and can alert them to potential problems within their organisation that need to be addressed; and
- it offers consumers and small businesses faster and less stressful dispute resolution than EDR schemes.

8.6 While ASIC has established regulatory standards for licensees' IDR schemes, existing legislation limits ASIC's ability to monitor compliance with these requirements on an ongoing basis.

8.7 There is very little accountability for the management of IDR schemes. If a licensee's IDR scheme was not functioning properly, it is not clear that ASIC would know.

8.8 Given that inadequate IDR schemes can significantly harm consumers, this is of concern. In the worst cases IDR schemes can operate as a delaying tactic that forces some complainants to give up on pursuing justice entirely.

8.9 Evidence provided to the Ramsey Review by a range of consumer groups suggests that there has been little change in the industry's approach to IDR since 2011, when ASIC reported that some IDR schemes could have 'the effect of frustrating and ultimately deterring some complainants.'[2]

8.10 This evidence is bolstered by the significant growth in the number of complaints handled by the FOS and CIO during their latest reporting periods (around seven per cent, respectively).[3]

8.11 These findings suggest that structural problems with IDR processes may currently be forcing consumers to seek redress through EDR schemes, if not abandoning their disputes all together. However, because ASIC cannot gather recurring data on licensees' IDR outcomes under existing legislation, it is not possible to draw firm conclusions at an industry and institutional level.

8.12 The committee therefore recommends that the Government empower ASIC to collect additional data on licensees' IDR schemes, such as:

- the number of disputes initiated;
- the number of disputes resolved;
- the number of disputes abandoned; and
- the average time taken to resolve a dispute.

8.13 This data will enable ASIC to better understand the system's failings and take action, if required. The committee further recommends that ASIC use this data:

1 to identify entities with IDR schemes that are not operating as expected and take remedial and, if appropriate, enforcement action; and

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2 ASIC, *Report 245: Review of general insurance claims handling and internal dispute resolution procedures*, August 2011, p. 34.

3 FOS, *Annual Review 2015-16*, 2016, p. 4 and CIO, *Annual Report on Operations 2014/15*, October 2015, p. 2.

2 to inform a review of ASIC's IDR scheme requirements, to determine whether changes are required (such as the inclusion of more formal rules) to improve consumer outcomes.

Monitoring compliance with Internal Dispute Resolution requirements

8.14 ASIC is a risk-based supervisor. ASIC focusses its activities on sectors and institutions that present the greatest potential harm to consumers and/or market integrity.

8.15 However, because ASIC does not have the power to collect recurrent data on licensees' IDR schemes,[4]it cannot determine which institutions' IDR schemes present the most potential harm to consumers. This makes it very difficult for ASIC to monitor institutions' compliance with IDR scheme requirements.

8.16 Given this knowledge gap, the committee is unsurprised that questions about whether ASIC dedicates sufficient resources to monitoring compliance with IDR requirements have been raised.

8.17 The committee is surprised, however, at suggestions by both Legal Aid NSW[5] and the Consumer Action Law Centre that ASIC has not responded to serious complaints about certain institutions' IDR processes. These complaints included that:

> [CBA's] IDR appears to be broken – one talks to different members of staff every time one calls; emails go unanswered, letters from us claiming breach of responsible lending have been treated as requests for hardship.[6]

8.18 This is of serious concern to the committee. Given the importance of IDR within Australia's dispute resolution framework it is critical that it operates as intended.

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4 ASIC, *Review of the financial system external dispute resolution framework: Submission by ASIC*, October 2016, p. 10.

5 Legal Aid NSW, *Submission to Review of the Financial System Dispute Resolution Framework – Issues Paper*, October 2016, p. 16.

6 Care Inc et al., *Submission to Review of the Financial System Dispute Resolution Framework – Issues Paper*, 10 October 2016, p. 26.

8.19 The committee therefore recommends that:

- ASIC respond to all alleged breaches of IDR scheme requirements and notify complainants of any action taken, and if action was not taken, why that was appropriate; and
- ASIC review its level of ongoing assessment of licensees' compliance with IDR scheme requirements to ensure that it is sufficient to ensure good consumer outcomes.

Internal Dispute Resolution Scheme Requirements

8.20 ASIC's IDR scheme requirements are set out in Regulatory Guide 165: *Licensing: Internal and external resolution*. Requirements include:

- IDR scheme compliance is to be self-certified;
- IDR procedures should account for the size and complexity of the business, the nature of the consumer base, and the likely number and complexity of disputes;
- disputes must be completed within 45 days (unless other timelines apply – for example, different timelines apply to some credit disputes);
- the licensee must have systems to identify disputes related to hardship so that these can be prioritised; and
- the IDR scheme must be capable of dealing with retail clients (which includes small businesses with less than 100 employees) at a minimum.

8.21 Australian Standard ISO 10002-2006 sets out additional requirements. For example:

- the organisation's top management should assess the needs for IDR resources and provide them;
- the organisation should be actively committed to effective and efficient complaints handling; and
- all complaints should be classified and then analysed to identify systematic, recurring and single incident problems and trends, and to help eliminate the underlying causes of complaints.

8.22 Principles-based requirements such as these have a number of advantages over a more explicit rules-based approach. For example they:

- allow regulations to keep pace with technological and market developments;
- promote compliance with the spirit of the law; and
- can be appropriate for all regulated entities.[7]

8.23 As ASIC describes in relation to Regulatory Guide 165:

> ASIC's guidance provides significant scope for firms to tailor their IDR procedures according to the size and nature of their business, the range of products or services on offer, the profile of their customer base and the likely volume or complexity of complaints they may receive.[8]

8.24 However, principles-based systems can also create ambiguity about specific requirements and about minimum standards of expected compliance.[9] For this reason, in many cases regulations should be a 'hybrid' of principles and rules, where detailed rules provide clarity and structure to supplement high-level principles that remain flexible and promote a culture of compliance.

8.25 Given potential failings in the financial sector's application of ASIC's IDR requirements, the committee believes that ASIC must review Regulatory Guide 165 to determine whether changes, including the introduction of formal rules for matters such as scheme resourcing, are required to improve outcomes.

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7 Australian Law Reform Commission, *For Your Information: Australian Privacy Law and Practice*, 2008, p. 234.

8 ASIC, *Review of the financial system external dispute resolution framework: Submission by ASIC*, October 2016, p. 9.

9 Australian Law Reform Commission, *For Your Information: Australian Privacy Law and Practice*, 2008, p. 236.

9. Boost Transparency in Wealth Management

"We have very significant concerns about the way the financial advice industry has operated" *Mr Peter Kell, Deputy Chairman of ASIC*[1]

"We did not report them at that time" *Mr Andrew Thorburn, CEO of National Australia Bank, on NAB's failure to report 43 dismissed financial planners to ASIC.*[2]

Recommendation 9

9.1 The committee recommends that the Australian Securities and Investments Commission (ASIC) establish an annual public reporting regime for the wealth management industry, by end-2017, to provide detail on:

- **the overall quality of the financial advice industry;**
- **misconduct in the provision of financial advice by Australian Financial Services Licence (AFSL) holders, their representatives, or employees (including their names and the names of their employer); and**

1 Mr Peter Kell, Deputy Chairman of ASIC, *Committee Hansard*, 14 October 2016, p. 13.

2 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 10.

- **consequences for AFSL holders' representatives guilty of misconduct in the provision of financial advice and, where relevant, the consequences for the AFSL holder that they represent.**

9.2 The committee further recommends that ASIC report this information on an industry and individual service provider basis.

9.3 The provision of poor financial advice is a systemic problem.[3]Given that almost half of all Australian adults have unmet financial advice needs[4] this presents a serious risk to the long-term financial health of Australians.

9.4 In the best cases, poor financial advice leaves Australians' investments and retirement savings facing elevated levels of risk. In the worst, Australians have had their savings wiped out.

9.5 It is a practice that has resulted in CBA[5] and NAB[6] alone paying out approximately $85 million in compensation since 2009. These figures will likely continue to grow.

9.6 Further, the provision of poor advice is far from the sector's only failing. Over seven years banks systemically charged consumers ongoing advice fees, even where no advice was provided.

9.7 ASIC has estimated that between 1 July 2008 and 30 June 2015, the sector collected up to $178 million from consumers that it was not entitled to. [7]

9.8 Given the above, it is not surprising that only 20 per cent of Australians trust banks to provide them with unbiased advice.[8] This is a trust deficit that the industry must repair.

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3 Mr Peter Kell, Deputy Chair of ASIC, *Committee Hansard*, 14 October 2016, p. 13.

4 ASIC, *ASIC's Corporate Plan 2016-17 to 2019-20*, 31 August 2016, p. 11.

5 Mr Ian Narev, CEO of CBA, *Committee Hansard*, 4 October 2016, p. 4.

6 Mr Andrew Thorburn, CEO of NAB, *Committee Hansard*, 6 October 2016, p. 17.

7 ASIC, *Report 499: Financial advice: fees for no service,* October 2016, p. 21.

8 Ernst and Young, *The Relevance Challenge: What retail banks must do to remain in the game,* September 2016, p. 4.

9.9 The industry’s failure to deliver for its customers has occurred for a number of reasons, including:

- financial advisors receiving commissions that incentivised the sale of certain products irrespective of the investor’s interests;
- financial advisors taking advantage of retail investors with poor levels of financial literacy;[9]
- conflicts of interest between product designers and distributors in vertically integrated institutions (each of the major banks is vertically integrated in this way);[10]
- financial advisors acting fraudulently;[11]and
- a poor institutional culture that does not put consumers first.[12]

9.10 In response to the industry’s repeated failings, government, regulators and industry have made a number of reforms to improve consumer outcomes.

9.11 These are critical reforms that are strongly endorsed by the committee.

9.12 The committee believes that further enhancing the transparency and public accountability of the financial advice industry would create the incentives necessary to better ensure that consumers’ interests are prioritised.

9.13 For this reason, the committee recommends that by the end of 2017, ASIC establish an annual public reporting regime for the wealth management industry, providing detail on:

- the overall quality of the financial advice industry;

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9 Senate Economics References Committee, *Scrutiny of Financial Advice Part I – Land banking: a ticking time bomb*, February 2016, p. xii

10 ASIC, *ASIC's Corporate Plan 2016-17 to 2019-20*, 31 August 2016, p. 11.

11 For example: ASIC, ’16-007MR Former Brisbane financial advisor jailed after pleading guilty to fraud charges’, *Media Release*, 18 January 2016, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-007mr-former-brisbane-financial-advisor-jailed-after-pleading-guilty-to-fraud-charges/>, viewed 27 October 2016.

12 ASIC, *ASIC's Corporate Plan 2016-17 to 2019-20*, 31 August 2016, p. 11.

- misconduct in the provision of financial advice by AFSL holders, their representatives, or employees (including their names and the names of their employer); and
- consequences for financial advisors found guilty of misconduct and, where relevant, the consequences for the AFSL holder that they represent or are employed by.

9.14 This information should be provided at an industry and institutional level and should build on the information provided in ASIC's August 2016 report on enforcement outcomes.[13]

9.15 This regime could be modelled on the proposed reporting regime for the life insurance industry, which will report claims data and claims outcome on an industry and individual insurer basis from 2017 onwards.

9.16 The establishment of a reporting regime for the life insurance industry is an important outcome of ASIC's review into claims handling practices and will create incentives for life insurers to improve their practices. It should be replicated in other industry sectors of concern.

9.17 Regular reporting of this information in the life insurance and wealth management industries will effectively supplement the information provided in each institution's public regulatory breach reporting (Recommendation 2) and further empower consumers to take their business to firms with a history of delivering for their clients.

Measures to improve consumer outcomes (enacted and announced)

9.18 Since 2011, the financial advice industry has been subjected to increasing levels of regulation (Table 9.1). Given the potential harm that the industry poses to consumers, this is appropriate.

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13 That is: *Report 485: ASIC enforcement outcomes: January to June 2016*, August 2016, pp. 8-9.

Table 9.1 Key measures to improve outcomes in the financial advice industry

Measure	Summary of Measure	Date enacted/expected to be enacted
Future of Financial Advice (FOFA)	The FOFA reforms aim to improve the quality of financial advice provided to consumers.	The FOFA reforms became mandatory from 1 July 2013, with ASIC's facilitative compliance ending on 1 July 2014. The Government's FOFA amendment Bill passed the Parliament on 2 March 2016.
Financial Advisors Register	A register of people who provide personal advice on investments, superannuation and life insurance. Includes details on qualifications and training.	31 March 2015.
New industry hiring standards for financial advisors	The industry has developed minimum standards for checking references and sharing information to ensure that rogue advisors cannot move between firms. *Note: according to the ABA only 38 per cent of the market has subscribed to these policies.*	Commitment announced on 20 September 2016.
Last resort compensation scheme for financial advisers	The ABA has announced the development of an industry model for a mandatory last resort compensation scheme covering financial advisers.	Model of last resort compensation scheme scheduled to be finalised in September 2017.

Measure	Summary of Measure	Date enacted/expected to be enacted
Life insurance advice remuneration	The Government is progressing reforms to improve the quality of life insurance advice. The reforms reduce the financial incentives for advisers to unnecessarily replace policies.	Legislation introduced on 12 October 2016. The reforms are scheduled to commence on 1 January 2018.
Raising professional standards	The Government is progressing legislation to raise education, training, and ethical standards for financial advisers.	Requirements commence 1 January 2019.
Enhanced ownership disclosure	The Government has committed to introducing legislation to ensure that financial advisers adequately disclose their relationships with associated entities.	Commitment announced on 20 October 2015.
ASIC's Wealth Management Project	ASIC's project aims to lift the standards of major financial advice providers – in particular, advice quality and the remediation of clients who have suffered loss as a result of their failure or action.	Ongoing.

Source: Government's response to the FSI, ABA

9.19 These reforms, coupled with the introduction of a product intervention power for ASIC (which will enable ASIC to modify, or if necessary, ban harmful financial products); product design and distribution obligations for financial service providers; and a broad review of ASIC's enforcement regime, should address the majority of the institutional drivers of poor financial advice.

9.20 However, they should be supplemented by the introduction of greater transparency. The committee believes that enhancing the public accountability of the sector will:

- empower consumers to make more informed choices in the financial advice market; and
- create additional incentives for institutions to improve consumer outcomes (including the ability for institutions to benchmark their performance against their peers).

Recommendation 10

9.21 The committee recommends that, whenever an Australian Financial Services Licence (AFSL) holder becomes aware that a financial advisor (either employed by, or acting as a representative for that licence holder) has breached their legal obligations, that AFSL holder be required to contact each of that financial advisor's clients to advise them of the breach.

9.22 In addition to the financial advice industry not being sufficiently accountable to the general public, the industry is not accountable enough to its own customers.

9.23 When a financial advisor is found guilty of misconduct, the committee believes that the clients of that advisor should be notified as soon as possible. The committee was disappointed to learn that this is not standard industry practice.[14]

9.24 AFSL holders should not expect consumers to be monitoring ASIC's website to learn of misconduct[15] – particularly misconduct that may have been systemic and may have resulted in their savings being placed at elevated levels of risk.

9.25 NAB has argued that in cases where the provision of poor advice was not systemic, and where some clients therefore did not suffer financial harm, that notifying all clients may create unnecessary stress.[16]

9.26 This argument is not compelling. Customers have the right to know if they have been advised by someone that has been found guilty of misconduct.

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14 Mr Shayne Elliott, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 8 and Mr Andrew Thorburn, CEO of NAB, *Committee Hansard,* 6 October 2016, p. 8.

15 Mr Shayne Elliott, CEO of ANZ, *Committee Hansard*, 5 October 2016, p. 8.

16 NAB, *Response to Questions on Notice: Question Five*, 20 October 2016, p. 5.

9.27 The financial advice industry needs to demonstrate that it has heard community concerns. In response to misconduct, the industry must demonstrate to each potentially affected client that the advice they received was good.

9.28 This is a necessary step to improve Australians' confidence in the financial advice industry.

Mr David Coleman MP

Chair
23 November 2016

A. Public Hearing Details

Tuesday, 4 October 2016 – Canberra

Commonwealth Bank of Australia

- Mr Ian Narev, Chief Executive Officer
- Mr David Cohen, Chief Risk Officer

Wednesday, 5 October 2016 – Canberra

Australia and New Zealand Banking Group

- Mr Shayne Elliott, Chief Executive Officer
- Mr Graham Hodges, Deputy Chief Executive Officer

Thursday, 6 October 2016

National Australia Bank

- Mr Andrew Thorburn, Chief Executive Officer
- Mr Antony Cahill, Chief Operating Officer

Westpac Banking Group

- Mr Brian Hartzer, Chief Executive Officer
- Mr Peter King, Chief Financial Officer

Transcripts for each of the hearings are available at: http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Four_Major_Banks_Review/Public_Hearings

B. Dissenting Report - Labor Members of the committee

1. Introduction

This inquiry was established by the Government to avoid a Royal Commission into Australia's banking industry. It has been a stage managed circus from its beginnings. The banks had full knowledge of the committee's hearing dates and schedule before the Labor members were appointed to the committee. One Bank CEO had discussed the committee's proceedings with the Treasurer during the same time period:

> Mr THISTLETHWAITE: You mentioned earlier that you had met with the Treasurer about this inquiry and a potential tribunal.
>
> Mr Hartzer: I would not characterise what I said that way.
>
> Mr THISTLETHWAITE: Sorry—about a banking tribunal. You admitted that earlier.
>
> Mr Hartzer: What I said is that I did not meet with the Treasurer to talk about this inquiry.
>
> Mr THISTLETHWAITE: No, but it came up as a topic of discussion in other discussions.
>
> Mr Hartzer: The tribunal was mentioned in passing.
>
> Mr THISTLETHWAITE: Okay. Did those discussions also include as one of the topics avoiding a royal commission?

> Mr Hartzer: Not in detail.
>
> Mr THISTLETHWAITE: In detail? At all?
>
> Mr Hartzer: I do not remember who said what exactly, but in the course of the conversation it would have been noted that there was a proposal to have a royal commission and that the government has instigated this set of meetings.
>
> Mr THISTLETHWAITE: As an alternative.
>
> Mr Hartzer: That would be one way to characterise it. I do not remember it being put that way.

When Labor members were appointed and sought to alter the hearing dates to allow more time for preparation and to provide additional days for questioning, the Coalition members used their voting majority to press ahead with dates pre-determined with the banks.

The banks have ridden roughshod over their customers, the Australian people, and the Turnbull Government is providing cover to protect the banking industry from further scrutiny.

Change in this industry only happens when you shine a light on those with power. Even now CBA is using its power to silence and punish whistleblowers,[1] a claim it denies. There is no authority in Australia that has the ability, resources or capacity to stop them from doing this.

Each of the Banks CEO's began these hearings with an acknowledgement of wrongdoing and a statement of contrition. Yet in place at all of the major banks are the same systems that drove their organisations to engage in unethical behaviour.

The one question the Coalition members' report fails to answer is why Australia should not have a Royal Commission into the banks?

The allocation of 20 minutes of questions for each member once every year is simply not enough. It is clearer now than ever, a broader inquiry is needed. The

1 Commonwealth Bank whistleblower Dr Benjamin Koh alleges smear campaign, ABC AM business editor Peter Ryan Posted 28 April 2016, 5:38pm, http://www.abc.net.au/news/2016-04-28/commonwealth-bank-whistleblower-alleges-smear-campaign/7368442

banks argue that a Royal Commission could drag on. This is not an argument against conducting a Royal Commission. This is a statement of fault, a frightened thought for years of misbehaviour. The only way to achieve any form of justice for the victims of the banks, and the only way to truly shine a light on the practices that drive unethical behaviour in the banking industry, is to hold a Royal Commission.

2. Banks have been acting unethically and ripping off customers

Recently, RBA Governor Philip Lowe noted that poor outcomes were a frequent occurrence within the industry:[2]

> Mr THISTLETHWAITE: Would you change anything?
>
> Dr Lowe: APRA is the financial regulator, so it is not the Reserve Bank. And APRA has made many changes to the nature of financial regulation recently—really around capital and liquidity. So I think the finance sector feels like it has gone through a period of very accelerated regulatory change. It is best, probably, to kind of let that settle and see how the system adjusts to it. I sense that you are asking about other types of regulation that really go to the issue of bank culture.
>
> Mr THISTLETHWAITE: Is there anything you want to say about that?
>
> Dr Lowe: I cannot help but agree with you that there have been too many examples of poor outcomes, particularly in the wealth management and insurance industries. That is disappointing to us all.

The head of the Australian Bankers Association, Steven Münchenberg, has said: “there are legitimate issues in the industry” and that “banks accept that in the past they have not always lived up to their own standards, let alone those of their customers.”[3]

2 Hansard, Standing Committee on Economics, 22/09/2016, Reserve Bank of Australia Annual Report 2015

3 http://www.smh.com.au/business/banking-and-finance/labor-calls-for-royal-commission-into-finance-20160407-go1dnr.html

The Apologies

Each of the banks CEO's admitted poor behaviour in their organisations:

Mr Ian Narev, CEO of CBA: "I have said before how sorry I am for the pain we have caused them. I say so again today."

Mr Shayne Elliott, CEO of ANZ: "Each time we fall short, we potentially harm a customer or a member of the community. For that, I apologise. When we fail our customers, it is my job to take accountability, apologise, fix it for the customer as quickly as possible and make the changes required to stop it happening again."

Andrew Thorburn, CEO of NAB: "Our advice was poor and wrong and not right, and I have apologised to them. We will continue to implement our customer response initiative. We believe it is being led well, it is comprehensive, it is thorough and it is has got lots of independence in it."

Mr Brian Hartzer, CEO of Westpac: "Westpac is not perfect. In recent years we have had operational errors, and we apologise for those. We have made some difficult decisions on pricing and at times we have not done a good job of communicating why we have made those decisions."

While the CEO's offer some level of apology there are still many questions that remain unanswered and many victims who have not received justice for the actions of their organisations.

ASIC Banning Orders

All four of the banks have been investigated by ASIC as part of its Wealth Management Project investigating financial advisers. As a result ASIC has issued temporary or permanent banning orders against multiple financial planners at each of the banks.

In the last year (October 2015 to October 2016) CBA Wealth Management Advice licensees have reported 15 advisers to ASIC and terminated 20 advisers.[4]

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[4] Financial Planners – sacked or reported to ASIC, 12 QON

NAB noted that 21 planners were dismissed for conflicts of interest, bad advice and compliance issues in a 2014 management report.[5]

Add to this ASIC has issued temporary or permanent banning orders against at least three ANZ Financial Planners in recent times: Wayne Meadth, Ben Cheung and Craig Miller. As well as banning orders against at least two Westpac Financial Planners Amanda Ritchie and Martin Hodgetts.

Open Advice Review

As well as the CommInsure scandal the CBA has the Open Advice Review Program which was established following the Commonwealth Financial Planning Scandal. CBA undertook to review client files back to 2003 to identify potential misconduct and bad advice:

> Mr Narev : Chairman, I will take a couple of those things specifically. No. 1: I have said before—indeed, I have said before in front of committees in Canberra—we did not act with the requisite speed many years ago, and even in more recent years, on the financial advice matters. We have acknowledged that and I repeat that to the committee today. Again, what I will say is this: as recently as Friday, Promontory, which is a globally recognised independent firm, produced its sixth report on the Open Advice Review Program. Actually, we got updated numbers since then that said that, of the 8,000 people, roughly, who wanted their advice review, 6,000 reviews have now been done. So far we have seen that in nearly 90 per cent of those cases the advice given was proved to be correct, but we paid an additional $11 million in relation to other claims. Bear in mind that a number of years ago, when we first undertook the remediation, we already paid out about $52 million. I want to emphasise one important aspect of this, and then David might speak specifically about the banned advisers. The Open Advice Review Program at the time was put in place not only to provide remediation to customers who did not receive advice of the standard they should have but to actually give confidence to everybody who received advice during that period that the advice they received is good.

5 Financial Planning matters – sacking of 37 financial planners 22QW

Many clients of Commonwealth Financial Planning remain unhappy regarding their treatment by CBA and the Open Advice Review.[6]

Some clients considered legal action against CBA and their cases remain outstanding.[7]

The RBA Cash Rate

The cash rate and the banks' refusal to pass on full rate cuts to customers have always drawn media attention.

When the Reserve Bank of Australia cut the cash rate in August 2016, CBA did not pass on the full value of the cut. Instead, the bank highlighted that it was passing on about half the cut while raising interest rates on some of its term deposit products.

It has since emerged that CBA has quietly unwound those rate rises again – cutting one-year rates from 3 per cent to 2.4 per cent, and two-year rates from 3.1 per cent to 2.45 per cent. This means the higher rates that CBA promoted as justification for not passing on the full rate cut on a much larger number of mortgages and business loans were in place for just two months.[8]

Westpac claim that the cash rate is not a significant determinant for their interest rates:

> Mr Hartzer: Each bank has a different funding situation. As has been noted in the discussions with the other banks, we do not fund off the cash rate.

ANZ also argue there is no connection between the cash rate and mortgage rates:

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6 http://www.smh.com.au/business/banking-and-finance/97yearold-fights-cba-for-compensation-after-shoddy-advice-from-dodgy-don-nguyen-20160902-gr7fut.html

7 http://www.smh.com.au/business/banking-and-finance/victims-of-commonwealth-bank-financial-planning-scandal-and-consumer-group-choice-question-schemes-independence-and-reach-20150120-12uncb.html

8 http://www.theaustralian.com.au/business/financial-services/commonwealth-bank-unwinds-term-deposit-rate-rises/news-story/e20b7c3c6e84155a686dd196db9f75bb

> Mr Elliott: When you say 'delaying', as I said, there is no direct link between the RBA cash rate and what we charge customers.

On Wednesday 19 October 2016, ASIC chairman Greg Medcraft confirmed that the main determinant of bank mortgage interest rates is the RBA official cash rate.

Mr Medcraft, himself a former banker, tabled a briefing note showing the banks funding costs "completely tracked" the cash rate, which he said reflected the fact that "60 per cent or more of their funding comes from deposits, which are based on the cash rate."[9]

This evidence from Mr. Medcraft shows the big banks' justification for not passing on a greater proportion of full RBA rate cuts to customers is weak. The banks have been short-changing Australian mortgage holders and making additional profits on the back of it.

CommInsure

The committee asked questions about the CommInsure scandal. Because of time constraints these questions barely scratched the surface of the issues at CBA's insurance arm.

Various media reports note that following whistle-blower revelations, CommInsure had systematically denied legitimate life insurance claims and relied on outdated medical definitions to do so. Commonwealth Bank committed to amend these definitions and review historic claims going back to at least 2014.

Dr Benjamin Koh, CommInsure's former chief medical officer detailed in a Four Corners report in March of 2016 that:

> Insurers pressured doctors to change medical opinions in order to deny payouts, that medical files went missing and outdated medical definitions were used to deny claims.
>
> Dr Koh said he repeatedly tried to raise his concerns with senior managers at CommInsure, and even went to the insurer's board, but he was dismissed in

[9] Mr Greg Medcraft, Economics Legislation Committee, 19/10/2016, Estimates, TREASURY PORTFOLIO, Australian Securities and Investments Commission

> August 2015, after less than two years in the role, for breaching the company's IT policy by emailing records to a personal account.
>
> Koh said he did it because files were going missing and he'd tried repeatedly and unsuccessfully to have the matter investigated before taking it to the board.
>
> He told journalist Adele Ferguson that legitimate claims were denied in a systematic fashion in order to boost CommInsure's profitability, including pressuring doctors to change their reports.[10]

Another shocking example is the case of Mr Mathew Attwater, who was medically terminated from his position at CBA after suffering from mental health issues. Yet CBA's own insurance arm, CommInsure, assessed him as capable of returning to work and denied his claim on that basis.

On the day before the committee hearings began the ABC 7:30 program uncovered the shocking case of Peta Ouutzen who was denied a life insurance claim by Comminsure:

> Mr CONROY: ….I want to go back to CommInsure for a second, in particular the tragic case of Peta Outzen that was explored last night on 7.30. The response quoted in the story yesterday was that the Commonwealth Bank, in declaring that Ms Outzen's death was a suicide in direct contradiction of a death certificate stating accidental overdose and a coroner's finding stating accidental overdose, simply made a mistake. Is that Commonwealth's position?
>
> Mr Narev : In the case of Ms Outzen, yes, that is correct. We are aware of the circumstances, and I might say they were tragic circumstances. The nature of the circumstances gave rise to an initial view from the claims manager that this had been a suicide, which obviously was incorrect. The coroner found that it was death caused by accidental taking of the drugs. As it happens, that in itself is also excluded from the policy, but having looked at the circumstances behind the way this determination was made I do not think it is a good example of dealing well with a customer, and, to come back to what I said

10 http://www.businessinsider.com.au/the-cba-now-faces-new-investigations-over-its-insurance-arm-2016-3

> before in response to Mr Thistlethwaite and the chairman, the bank needs to be doing a better job at those sorts of circumstances.
>
> Mr CONROY: How can the bank maintain it was simply a mistake when the claims assessor, post their initial claim, clearly ignored the coroner's finding and the death certificate? That is not a mistake. A mistake is losing someone's paperwork. It is not a mistake to say, as a claims assessor, 'I know more than the coroner.'
>
> Mr Narev : I will take this aspect on notice, but I have not yet been made aware that any claims manager wilfully ignored a determination of a coroner. What I have been made aware of to date is that, based on the circumstances of the case, the claims manager made a conclusion which was mistaken and did not take into account other factors. There actually is a process to make sure that if that happens it receives additional oversight, which did not happen. Regardless of whether or not the circumstances of what was a tragic death would or would not have been covered, I come back to saying that that is a process which was not a customer-friendly process.

CBA's focus is clearly not on every individual customer. These cases are all too common. Only a broader inquiry with the powers of a Royal Commission will be able to fully investigate these matters and the many who don't receive media attention.

This year ASIC conducted a review of the life insurance market. The report, released in October, noted that there were issues of concern in relation to higher claims denial rates and claims handling procedures associated with particular types of policies. For instance the rates of declined claims were highest for TPD cover, with an average declined claim rate of 16 per cent, and TPD denial rates being as high as 37 per cent.[11]

2016 ASIC Matters

Throughout the course of the year ASIC has investigated a range of matters resulting in fines and repayments to customers. The Labor members of the

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11 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-347mr-asic-issues-industry-review-of-life-insurance-claims/

committee wish to highlight some of the enforcement functions of ASIC and the size and scope of the compliance failures that are all too common at the big banks.

CBA Infringement Notices

In September 2015 it was announced that CBA had paid four infringement notices worth $180,000 in relation to breaches of responsible lending laws when providing overdraft facilities.

As a result of the error, between July 2011 and September 2015, CBA failed to take into consideration the declared housing and living expenses of some customers. CBA informed ASIC that between July 2011 and September 2015, as a result of the error, CBA approved: 9,577 people for overdrafts which would have otherwise been declined; and 1,152 people for higher overdraft limits than would have otherwise been provided. CBA has written off $2.5 million in loan balances as a result of this error.[12]

ANZ Transaction fee refunds

In September 2016 ASIC announced that ANZ had refunded $29 million to hundreds of thousands of accounts after failing to disclose certain periodical payment fees.[13]

Westpac Transaction fee refunds

In September 2016 ASIC announced that Westpac had refunded $9.2 million in bank fees that should have been waived in one case, and $20 million in credit card foreign transaction fees in another.[14]

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12 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-308mr-cba-pays-180-000-in-penalties-and-will-write-off-25-million-in-loan-balances/

13 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-291mr-anz-to-refund-nearly-29-million-to-more-than-390-000-accounts-as-a-result-of-unclear-fee-disclosures/

14 http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-304mr-westpac-refunds-92-million-after-failing-to-waive-bank-account-fees-for-eligible-customers/

CBA financial advice refunds

In October 2016, ASIC announced CBA would repay $105 million to customers who had been charged for financial advice that was never provided.[15]

3. The banks' structure and culture promotes bad customer outcomes

Each of the banks gave evidence to the committee that they have remuneration structures and targets that incentivise cross selling of bank products to customers, particularly insurance and credit products, even though they may not be in the customer's best interests.

Sales targets

Sales targets are included for frontline staff. Frontline staff can include – branch managers, customer service managers, customers service representatives etc. Sales targets are part of a 'balanced scorecard' that is used to determine performance. Sales targets typically make up to 30 per cent of the balanced scorecard metric for frontline staff. Balanced scorecards include metrics measuring an individual employee's performance.

Through this metric staff are required to meet a rate of at least 100 per cent is the sales target. The only metric that is discussed everyday by managers is the sales target. Failure to reach the required sales target will result in the implementation of performance improvement mechanisms and may result in the removal of underperforming staff from the business.

Targets are employed at every level of the business and are the key driver of poor behaviour.

Sales are also measured and compared to co-workers and other branches, regions and business units. This process is compiled into functional ranking systems known generally as league tables.

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15 ASIC Report 499, Financial advice: Fees for no service October 2016, Page 20, http://download.asic.gov.au/media/4054607/rep499-published-27-october-2016.pdf

Culture

At the centre of the problem is a cultural issue within the sector, that is geared towards selling products to customers. There is little to no understanding of the best interests of the customer. Drivers such as performance targets and bonus payments exist to push staff to make sales and drive profits for the banks. Customer need is a secondary issue. The bank CEO's will argue that customer needs are taken into account by employees because they utilise a balanced scorecard for all employees' performance management.

However this balanced scorecard still means that if you're an employee that is failing to reach your sales goals you may be managed out of the business. An employee may face the prospect of a choice between selling bad or unsuitable products and losing their job:

> Mr THISTLETHWAITE: So, if they are struggling and they are not meeting their targets, does that include perhaps using that information to put them on a performance improvement program?
>
> Mr Thorburn: The performance improvement program is something that comes quite a way down the process, and what a leader should do is look at the balance scorecard. How is the individual doing on customer, risk, financial, and leadership and people—working with colleagues? And then they should be sitting down with them regularly…
>
> Mr THISTLETHWAITE: And that performance improvement program can include warnings about behaviour and ultimately dismissal, can't it, if they do not improve?
>
> Mr Thorburn: Yes, that is true, but I think all businesses in Australia would have that sort of discipline, and that comes at the end of a long process of coaching and counselling and helping people to get better.

4. The current regulatory framework is inadequate to prevent poor customer outcomes and provide redress for victims

The heads of ASIC, APRA and the ACCC admitted that they do not have the legislative foundation or the funding and resources to properly regulate and scrutinise the banking industry particularly in respect of their culture, behaviour and competition.

The Australian Reported in March 2015 that ASIC chairman Greg Medcraft was quoted as saying “It's frankly quite clear that we're very thinly resourced across the board” following budget cuts in the 2014-15 and 2015-16 Budgets.[16]

ACCC can’t look at competition on its own initiative

The ACCC has a range of limitations including an inability to begin self-initiated market studies and a lack of resources for dealing with investigations. The Chairman, Mr Rod Sims detailed his frustrations when appearing before the committee on 14 October 2016:

> Mr THISTLETHWAITE: the UK's Competition and Markets Authority has the power to conduct extensive market reports of its own volition. Is this something you think the government should consider in Australia in terms of your powers, rather than having it done through referrals or compliance work?
>
> Mr Sims: I think it would be a good idea, to be honest about it. The United Kingdom regulator is probably more advanced than in most other countries in its use of market studies. Certainly we had them out here trying to convince Ian Harper that it was a good idea, and we did not succeed.
>
> At the moment we can do market studies under one of two headings. One is that we can self-initiate, in which case we can get information only voluntarily. The only way we can get information using our compulsory powers in a market study is if the government refers the matter to us, as they have done with petrol, as they have done in the east coast gas market and as they are now going to do in dairy. Our beef market study is one that relies on voluntary information and clearly we have had limitations in the information we have been able to get in terms of understanding where the money is made in the value chain. You are not going to get that information voluntarily. That is such a crucial ingredient in many of these sorts of studies. Firstly, I think having that sort of power would be helpful. I emphasise again, though, that with our resources we would still be doing one or two a year, and that is roughly what the UK does as well. They are able to do only one or two a year.

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16 http://www.theaustralian.com.au/business/latest/asic-slams-penalties-budget-cuts/news-story/c37addc981d397c9de4bb24e4db86102

> Mr THISTLETHWAITE: That was going to be my next question: do you think it would require additional resources?
>
> Mr Sims: Just to go back to the chairman's original line of questioning, it depends on the government and how much they want us to do. I think personally if we were to get more resources I could use it most in the investigation area on breaches of the consumer law and breaches of the competition law, because it is frustrating that we do see breaches of the law that we cannot deal with or we are trying very hard to deal with it but because we have so many priorities things take longer than they should. So, it is a serious problem for us.

A lack of Executive Accountability

A key community concern in relation to bad behaviour by banks has been the lack of accountability of senior executives and directors for failings within banks:

> Mr CONROY: But some of these cases are over three years old. The media stories that broke this are somewhat old now. I appreciate you have got a formal process to look at the broader issues, but you have already acknowledged that the bank did the wrong thing in some of these cases. Are you not able to tell me whether anyone suffered any consequences—any disciplinary action—over any of these matters?
>
> Mr Narev : There is a range of disciplinary action and it is all taken into account when we get the full facts and circumstances.
>
> Mr CONROY: Is that a yes or a no, Mr Narev? Has anyone been disciplined?
>
> Mr Narev : At this stage, there are certainly individuals who we know enough about that we have had discussions with and who have had some consequences relating to remuneration. At this stage, we have not had individuals terminated as a result of this, because we have not seen the need to do that. If we do, we have got very clear principles on it. We will make sure that happens.

The United Kingdom has recently introduced reforms – the Senior Managers Regime – that create a statutory duty of responsibility that requires senior managers to take reasonable steps to prevent regulatory breaches from occurring, or continuing to occur, in their area of responsibility. This is leading many senior managers to reassess the appropriateness of the scope of their responsibilities and to review their approach to controlling and managing these areas of responsibility.

The UK Prudential Regulation Authority and UK Financial Conduct Authority new rules establish a framework to:

- create focused accountability on individual senior executives within banks;
- encourage such senior executives to take greater individual responsibility for their actions; and
- make it easier for banks and regulators to hold individuals to account.

Key elements of this framework include:

- identification of Senior Management Functions, being board director and senior executive management positions, which require pre-approval by regulators;
- requirement to allocate prescribed responsibilities among the Senior Management Functions;
- creation of key governance arrangements in a Management Responsibility Map with Statements of Responsibility for each Senior Management Function;
- requires banks to annually certify the fitness and propriety of key employees; and
- imposes codes of conduct on senior managers and all other employees.[17]

The potential for the introduction of a statutory responsibilities and transparency as to which senior managers are responsible for certain activities within banks in Australia was raised by the committee with bank CEOs, ASIC and APRA.

Both ANZ chief executive Shayne Elliott and Westpac chief executive Brian Hartzer expressed a level of support for a strengthened accountability regime for senior executives and managers, similar to Senior Managers Regime recently introduced by the UK Financial Conduct Authority:

> Mr KEOGH: The UK Financial Conduct Authority has brought in this strengthening accountability framework. I am sure as an international bank, as

17 Deloitte EMEA Centre for Regulatory Strategy. Senior Managers Regime: individual accountability and reasonable steps. 2016.

> you are, you would be aware of this—their process of having rules on individual accountability, the senior managers' regime and the remuneration code. Do you see some merit in that approach?
>
> Mr Elliott: Yes.
>
> Mr KEOGH: Is that something you think should be considered here?
>
> Mr Elliott: I think that that tightens accountability for senior executives and is something that should be looked at. That is only reasonable.
>
> Mr KEOGH: I think the key thing here about what I am asking you though is—we are not saying do not take risk and we are not saying do not innovate—that where people take that risk, or the bank as an organisation decides to take that risk, with what is effectively other people's money by advising them to put it into certain products or to buy certain products from the bank, that the advisers are responsible for it, but also that their senior management are responsible for the culture that surrounds that and for the systems that are in place and the training that has been put in place, so where that advice is given and risks may be advised to be taken, that there is a chain of accountability and responsibility for that.
>
> Mr Hartzer: And I support than wholeheartedly.

Both the ASIC and APRA Chairmen, Mr Medcraft, and Mr Byres, also expressed favour to the concept:

> Mr KEOGH: Okay. Ms Banks mentioned earlier—probably in quite a different context—the UK senior managers regime. I asked all of the banks about that during the course of the hearings we had last week. I would just be interested to know: in terms of being able to add to the arsenal that ASIC has at its disposal, does ASIC see that form of regulatory regime—I am not talking about the absolute specifics of what the FCA have introduced in the UK but, if you like, a statutory or regulated requirement on senior management personnel within a financial service, banks or otherwise, to take responsibility for their areas of responsibility, and the requirement for a financial service to identify the people who are responsible—as a useful way forward for the regulatory regime in Australia?
>
> Mr Medcraft: Clearly that is a matter for government, but the—
>
> Mr KEOGH: Well, I am asking you as the regulator.

> Mr Medcraft: No, that is okay. That is just a preface. But I have looked very closely at that because, as you know, I was headhunted to run FCA this year. With the senior manager regime, first of all, I think personal accountability is really important, and I think we have seen what happened with Wells Fargo this week.
>
> Mr KEOGH: Yes.
>
> Mr Medcraf: So I think that is important. I am not really philosophically at a view of trying to micromanage companies. I think they are responsible, they should be held responsible and they should make people responsible, clearly, and I think they want to. With the senior manager regime to date, they changed the onus. It seems to be working well, but again I think it is premature to judge whether it is a success or not. But the results to date are quite positive.

While the Chair's report claims the committee is "committed to increasing executive accountability in the financial sector", the recommendation to address this – public reporting of AFSL breaches, is flawed and would be ultimately ineffective at addressing the need to make executives accountable.

The Chair's report notes the introduction of the Senior Managers Regime and that its progress will be monitored but like much of the report, this is a meaningless statement.

The intention of the UK regime could be replicated in Australia, but differences in the financial systems of the two countries and their regulatory structures mean the regime itself could not simply be copied.

The complexities of introducing such a regime need to be thoroughly investigated in an Australian context. The only vehicle to run such an investigation is a Royal Commission.

5. The Government Members' Report Recommendations

Recommendation 1

The recommendation for the creation of a tribunal to replace existing EDRs is essentially half formed and pushes responsibility for its development to yet another government inquiry.

Indeed, the genesis of this majority recommendation appears to have been prior discussions between the Prime Minister, Treasurer and bank CEOs:

> Mr KEOGH: Mr Hartzer, have you had any conversations with anyone in the government about this idea of setting up a tribunal to deal with customer complaints prior to today?
>
> Mr Hartzer : I think I was at one meeting a couple of months ago where the idea was mentioned. It was certainly not an extensive conversation.
>
> Mr KEOGH: Who was that with?
>
> Mr Hartzer : I would guess that it might have been the Treasurer.
>
> Mr KEOGH: It might have been?
>
> Mr Hartzer : As I say, it was several months ago. I would say I have probably had a very short conversation with the Treasurer about it, but I could not swear to that. My memory is a bit hazy.
>
> Mr KEOGH: What sort of suggestion about the tribunal was put to you in that conversation?
>
> Mr Hartzer : There were no details. Actually, I do remember—sorry. I know where this came up. There was a meeting with representatives of the banks. It was in the press. It was April, May—I cannot remember exactly— and there was a discussion and one of the issues that was raised was about resolution of complaints and whether that whole thing needed to be looked at. We agreed, as I said in my earlier response, that it is important that there is an appeal process. If there is a gap between the different institutions then it is reasonable to look at that.
>
> Mr KEOGH: So the idea of a tribunal was raised at that meeting. The Treasurer was present at that meeting and you said representatives of other banks were also present at the discussion?
>
> Mr Hartzer : Yes. It was in the press at the time that there was a discussion between the Prime Minister and the Treasurer and representatives of the banks. I believe that that was one of the items that came up in that discussion.
>
> Mr KEOGH: What was the view that you and your bank expressed about that idea at the time?

> Mr Hartzer : It would have been what I said in my response earlier, which is that we are very happy with the idea that the architecture of appeal, to use my own word for it, should be looked at. If there is an issue of people falling between the stools or having limits that are too low, we are very supportive of that being looked at.
>
> Mr KEOGH: Initially your response was you thought that that was a few months ago. You then said there was a discussion in around April or May. Has this issue been raised with you subsequent to April and May but before today?
>
> Mr Hartzer : I could not tell you definitively. What I can absolutely say is I have never had a long conversation about the topic of a tribunal. I am not really even aware of what the details are of what is recommended. My immediate response is that I am very happy for that issue to be looked at—whether there is a gap in what sorts of customers are eligible to go to a review process. I accept that there might be places where there is overlap or gaps in coverage and it seems perfectly sensible to us that that would be looked at. As to whether the answer to that is a tribunal, a new institution, a merging of some institutions or a reframing, I am completely agnostic.
>
> Mr KEOGH: But you cannot rule out that there has been a conversation more recently where that may have been raised in some degree of detail that you cannot properly recall at this point?
>
> Mr Hartzer : Correct.

The Labor committee members note that a range of sector stakeholders and consumer advocates have raised very strong concerns about the tribunal approach.

A coalition of consumer advocates, made up of Care Inc, Caxton Legal Centre, Consumer Action Law Centre, Consumers' Federation of Australia, Financial Counselling Australia, Financial Rights Legal Centre (among others) went so far as to write to the Prime Minister stating that they are 'very concerned that a new tribunal may in fact deliver worse outcomes for consumers'.[18]

18 http://www.afr.com/business/banking-and-finance/financial-services/credit-ombudsman-says-new-bank-tribunal-would-be-a-huge-mistake-20161010-grzco8

Furthermore, the current Credit Industry Ombudsman, Raj Venga, stated publicly that a new banking tribunal would be a huge mistake.[19]

These stakeholder concerns are significant and should not be brushed aside by the committee or the Government without addressing their substance.

On the face of it, the tribunal model proposed by the majority report also falls short in several significant aspects of the law. For example, the detail provided in the majority report, appears to give rise to conflicts in structure that may make the creation of the body envisaged by the majority run into issues in respect of Chapter III of the Australian Constitution.

For instance, the proposed structure of a board and members gives the appearance of a the tribunal being a private body, such as the FOS, where members who volunteer to be members make a contractual agreement to be bound by FOS determinations.

However, the proposal also envisages compulsory membership and that decisions are binding by force of statute. This statutory compulsion to participate in tribunal proceedings and comply with decisions begins to take on judicial like qualities, similar to the SCT, which is a statutory body. Further, the nature of the decisions that such a tribunal would be making may well require that the body be invested with full judicial power. In either event, it would be improper for such body to be a private member based organisation, but rather a judicial one.

These conflicts require resolution in determining:

- who will preside over such a tribunal;
- the jurisdictional limits that apply;
- the scope of matters that may be dealt with by the tribunal;
- what procedures would apply; and
- what avenues of appeal may or may not exist.

There is a further issue created by the suggestion that lawyers not be permitted to be involved in respect of the tribunal. Like many well intentioned suggestions of

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19 http://consumeraction.org.au/edr-review/

this nature by committees and other bodies before it, this fails to account for the involvement in advising banks in proceedings of an army of internal lawyers at the disposal of each bank. Merely preventing lawyers appearing in a tribunal will not create a level playing field. Indeed, funding for legal assistance for customers would be of greater assistance in levelling the playing field, as well as ensuring the adoption of customer friendly procedures.

- As can be seen, the committee's recommendation opens more questions than it addresses and is a further demonstration of the requirement for a detailed and in-depth look not just at the sins of the past but also how they can be remedied in the future. An inquiry, such as the Ramsay Review, into EDRs in isolation to all other issues will be insufficient to properly address these concerns. These matters can only be addressed holistically through a Royal Commission.

Recommendation 2

There are a number of practical flaws with this recommendation:

The Chair's report has not made it clear how this would work in practice without compromising larger investigations or examination of misconduct.

While there is a clear need for more and better public reporting of breaches of corporate law or licensing requirements within financial institutions, and for greater accountability by senior executives where these occur, the model proposed in this report displays the same rushed and ill-thought-through approach as the Turnbull Government has demonstrated throughout this entire inquiry.

Recommendation 3

Recommendation 3 proposes the creation of a new team within the ACCC, without making any recommendation for additional funding to the ACCC to fund this work. In October the committee heard from the Chairman of the ACCC about its market studies program and that the ACCC is limited in the number and scope of market studies that it conducts to analyse levels of competition in a particular market space due to funding constraints.

This recommendation appears to effectively create a team to run regular market studies of the banking sector. It would appear more effective if the ACCC was

properly funded by Government to run market studies and directed by Government to conduct market studies into the banking sector. However, given the size and scope of such a study, the ACCC would be greatly assisted if an initial examination of competition issues in the banking sector was conducted through resources available to a Royal Commission.[20]

Recommendation 6

The proposal for the Council of Financial Regulators to review licensing requirements for ADIs and for a 'two phase' licensing process appears superfluous as the majority report does not consider evidence provided to the committee in a separate hearing by Mr Byres, Chairperson of the Australian Prudential Regulation Authority:

> Mr Byres: The $50 million is not actually a prevention to be an ADI. It is a threshold below which you are not able to use the word 'bank' in your business name. But we have a large number of ADIs that operate below the $50 million—typically credit unions and building societies— but there are some other organisations that choose not to have the word 'bank' in their name. They have an ADI authority, they meet the prudential requirements and they can do banking activity without the $50 million.
>
> CHAIR: Yes, but, if you are proposing to set up a bank, you would be required to have the $50 million prior to lodging the application with you?
>
> Mr Byres: The second thing is, no. The way our application process works is that when it comes to ADI licences we actually have what I would call a fairly iterative process. We work with applicants. The only thing you need to pay up-front is an $80,000 application fee, which is a cost recovery measure. It covers our costs for processing the application. You have to have the $50 million, certainly, before we sign the licence over to you, but it is not the case that you have to show a bank statement when you first roll up at APRA. Those are my two clarifications on the $50 million.

20 Hansard, Standing Committee on Economics, 14/10/2016, Australian Competition and Consumer Commission annual report 2015

Recommendation 7

As the majority report notes at table 3.1, all AFSL holders are required to "have adequate risk management systems" and to not do so would amount to a significant breach, that such AFSL holder would have to report to ASIC.

Furthermore, APRA Cross-industry prudential standard (CPS) 220 – Risk Management requires an APRA-regulated institution to have systems for identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating material risks that may affect its ability, or the ability of the group it heads, to meet its obligations to depositors and/or policyholders. These systems, together with the structures, policies, processes and people supporting them, comprise an institution's risk management framework.

In addition, APS310 (ADI Prudential Standard 310 – Audit and Related matters), APRA can require an ADI (i.e. a bank) to audit its risk management systems. As such, it would be more appropriate to recommend that APRA direct banks to audit their risk management systems, with such audit report to be provided to APRA. However, the concern in relation to risk management system implementation and compliance discloses a larger concern, regarding whether APRA and ASIC are properly enforcing their regulatory domains, given that ineffective risk management would result in serious breaches of AFSL conditions and prudential standards. It is such concerns that support the need for a broader inquiry in the nature of a Royal Commission.

Recommendation 9

The Labor members agree that additional transparency measures via public reporting are much needed for the wealth management industry. However the recommendation as it stands may be unworkable. A properly formulated recommendation of this nature would need to focus on breaches that relate to client files or work performed on behalf of or in relation to a client.

Interbank ATM fees

An issue of continual frustration to many banking customers is the level of fee charged by a bank for using its ATM when a customer of another bank.

During the course of the committee hearings NAB and Westpac were asked to provide information as to the marginal cost to banks for allowing customers of another bank to access the bank's ATM network. All banks were requested to provide more detailed information in writing after the hearings.

During the course of the hearings, Westpac informed the committee that such marginal cost was approximately 20 cents. Given that the fee charged to non-bank customers for using an ATM is approximately $2.00 or more, this fee appeared to represent a mark-up of approximately 900 per cent.

NAB provided information on a public basis that such marginal cost was approximately 62 cents, showing a margin of at least 222 per cent.

It is disappointing therefore that in responding to these questions in writing CBA and ANZ only provided information on the basis that it was kept confidential.

While noting that the cost base for providing their ATM networks is one that not only increases over time but also increases on a per transaction basis as the number of ATM transactions continues to decline, this is effectively a cost that the banks would meet in order to service their own customers in any event. It is therefore apparent that the fees charged to non-bank customers are not related to the additional cost of servicing those customers but rather a way of mitigating the overall costs of the banks' ATM network. The existence of non-bank ATMs which also charge a fee for ATM use to all customers, appear to have set a market price for such a service which has allowed banks to charge a similar fee, disconnected from the cost base.

While the pricing of such services is a matter for each bank, the lack of transparency about the calculation of this charge has increased customer scepticism with banks.

Issues relating the responses to questions in writing:

Members of the committee sought further information following the 20 minutes of questioning allowed under the flawed structure of the inquiry. Some questions were then taken on notice or in writing.

Some of these questions in writing were answered fully and properly. For example NAB answered one question from the Deputy Chair on Bank staff performance

measures and incentives and balanced scorecards with significant attention to detail and seven annexures.

However some of these questions were answered poorly or need follow up to clarify their meaning and the committees understanding of them. This cannot happen until the CEO's appear at next year's hearings, if at all.

26QW - Banks staff performance measures and incentives

Despite claiming not to use leaderboards CBA acknowledged providing data to managers for coaching and performance purposes. However no detail was provided as to how this data is used by managers with their staff or how widely available this data is to other employees.

This answer raises further questions which cannot be asked under the current restrictions relating to this inquiry.

27QW - Accountability - code of conduct breaches

In response to this question CBA tabled the number of investigations undertaken into suspected beaches of their Statement of Professional Practice and then a further table outlining the number of employees no longer with the group.

No senior executives were investigated despite the fact that they have benefitted through bonus payments linked to financial outcomes derived from the alleged wrong doing of staff reporting to them.

Again, this answer raises further questions that cannot be asked until the banks appear before the committee again.

27QW - Bank staff performance measures and incentives

In response to this question regarding bank staff performance measures and incentives NAB provided an average figure. The use of an average for all NAB employees is misleading. By providing an average figure it is not possible to understand the at-risk component of the employees at different levels within the bank. For instance a comparison between a teller and the CEO might show that decision makers have around 60 per cent of their remuneration at risk while tellers may have less than 5 per cent at risk.

40QW - Bank staff performance measures and incentives

In response to a request to provide a copy of a balanced scorecard Westpac chose not to provide this information. Westpac's failure to provide the scorecard requested raises questions as to how balanced the scorecards actually are.

6. The House of Representatives Economics Committee is no substitute for a Royal Commission.

This inquiry exists as a mechanism to avoid further scrutiny through a broader inquiry. Each member of the committee had around 20 minutes to question the Bank CEO's over 3 days. The Labor members of the committee all ran out of time.

The one question the Coalition members report fails to answer is why Australia should not have a Royal Commission into the banks?

The process the Government undertook to set up this inquiry was flawed and put the committee at a disadvantage. The inquiry was announced and banks provided with dates prior to committee membership even being finalised, and committee members were only given a few short weeks to prepare.

This inquiry process effectively locks the public into a process of needing to wait 6 months for another hearing to seek more information. This is unreasonable and further proof the government is shielding the banks from scrutiny.

There are thousands of documents provided by the banks that are sealed – these secret documents deserve greater scrutiny. These documents cannot even be referenced in this report.

7. Labor Members' Recommendation

This inquiry process was initiated by the Turnbull Government as a distraction from the need for a banking Royal Commission.

Having achieved nothing but to emphasise the inadequacy of this approach for holding Australia's major banks to account and identify the significant scope of concerning malpractice which remains to be examined, Labor committee members recommend the Government immediately move to establish a Royal Commission into the Australian banking and financial services industry.

Such a Royal Commission into the financial services industry should examine issues such as:

- how widespread instances of illegal and unethical behaviour are within Australia's financial services industry;
- how Australia's financial services institutions treat their duty of care to their customers;
- how the culture, ethical standards and business structures of Australian financial services institutions affect the behaviour of these institutions;
- whether Australia's regulators are really equipped to identify and prevent illegal and unethical behaviour;
- comparable international experience with similar financial services industry misconduct and best practice responses to those incidents; and
- other events as may come to light in the course of investigating the above.

This Royal Commission should be initiated without delay to ensure justice for victims of banking misconduct and restore public confidence in the Australian banking sector which has been badly damaged by the string of scandals in recent years.

Signed:

Hon Matt Thistlethwaite MP

Deputy Chair

Mr Matt Keogh MP

Ms Madeleine King MP

C. Dissenting Report - Greens' Member of the committee

This inquiry has confirmed that the big four banks enjoy a cosy and privileged position in Australian society, making large profits off the back of the kind of implicit (and explicit) taxpayer support other businesses can only dream of.

This inquiry has also confirmed the big four banks think there is nothing wrong with the core of their vertically integrated business model, a model that creates a potential for conflict of interest between the customer's best interest and subsidiaries encouraging people to buy financial products.

This committee's Inquiry into the big four banks has also thrown up new areas of concern, suggesting that growing household debt underpins in the high levels of profit the banks say they need to make for their shareholders, meaning that their business model is increasingly premised on housing remaining unaffordable for many young people.

This inquiry has generated more questions than answers, reinforcing the need for a wide-ranging Royal Commission into the big four banks and the broader financial sector.

Unfortunately, the committee's report does not address any of these fundamental issues. In the short time available to consider and respond to the committee's report, the Greens have been unable to endorse its sentiments and draw attention here instead to some crucial issues that require further action.

1. Leaners, not lifters

Australia has one of the most concentrated banking sectors in the world. Together, ANZ, CBA, NAB and Westpac have over 80 per cent of the market in home loans, hold $3.6 trillion in assets and make around $40 billion per annum in profit. The big four banks enjoy incredible market dominance, which gives them extraordinary power.

What makes this situation even more concerning is that the taxpayer underwrites the big banks' privileged position, giving them a license to print money.

A study completed by the RBA, and released under a Freedom of Information request, states that Australian banks' credit ratings are benefited by the "rating agencies' perceptions that the Government would support them if they got into trouble". According to the RBA, in 2013 Australia's major banks received a subsidy worth up to $3.75 billion from the Federal Government.

During the inquiry, the banks made it clear they knew they get a financial benefit from the public underwriting them, as this exchange shows:

> Mr BANDT: Thanks. On another matter, as one of the big banks you get to borrow funds to fund your operations and your subsequent loans more cheaply than your competitors. Is that a fair statement?
>
> Mr Narev [CBA]: In some aspects, yes—part of which was redressed from the capital costs by the recommendations of the financial system inquiry, where the four major banks raised $20 billion of capital and the next banks did not have to raise any.
>
> Mr BANDT: But even after that, on the whole wholesale funding is still cheaper for you than it would be for smaller banks or credit unions?
>
> Mr Narev: In most cases, that is right.

It is also clear they are not prepared to return anything further to the public purse in part compensation for this support:

> Mr Hartzer: … I do not think we should aspire to have a banking system like the rest of the world.

> Mr BANDT: I do not think anyone is suggesting that. We are wanting you to be stable and successful, but when you are making world-leading record profits off the back of implicit government support, the public is entitled to ask for a bit of it back, aren't they, rather than bearing all the costs themselves?
>
> Mr Hartzer: I would take issue with the assumption of that. We pay, already, for the CLF and the RBA. We, as domestically significant banks, are required to hold higher capital than the smaller banks are. I would just make the observation that if you were to start to charge banks for an implicit guarantee, you are effectively making that an explicit guarantee, and I think the government would want to be pretty careful given that we do not actually guarantee our large banks to make that an explicit undertaking.

It is time to call a spade a spade. If we have a de facto policy that the public will step in and support the big four banks if they ever get into trouble, as the government did during the GFC, then the big four should make appropriate recompense back to the public purse. Any other business in Australia would love to know it had the government's backing if it ever got into trouble. But if we're not offering guaranteed financial security to businesses in the manufacturing sector, renewable energy or tourism, why do we decide that large banks deserve government help?

Recommendation: That a levy of 0.20 per cent be applied on the asset base of institutions with an asset base greater than $100 billion.

The rate of this levy is equal to the lower bound of the RBA's estimate of the value of an implicit government guarantee. It is also the value suggested by the IMF based on the average benefit of implicit guarantees throughout the G20.

2. Vertical Integration and Conflicted Remuneration

The catalyst for this inquiry is the seemingly endless spate of scandals within the financial advice arms of the big four banks over recent years. These scandals have seen tens of thousands of Australians lose money, and have eroded trust in the financial services sector.

The genesis of these scandals can be found in the 'vertically integrated' business model that has been universally adopted by the big four banks. Investment advice and insurance products are now part of the same business as conventional deposit

and loan services. This creates a conflict of interest between what is good for a customer and what is good for a bank.

It is not just the Greens raising these concerns. The RBA and ASIC have both drawn attention to the inherent risk with vertically integrated banks. The former head of the Financial Services Council, John Brodgan, put it bluntly when he said "vertical integration and flawed remuneration policies are plaguing the banking and financial services industry."

The Senate in its inquiries has also established a strong prima facie case for a Royal Commission.

Yet the banks do not see any problem:

> Mr BANDT: I want to put you that there is a common pattern developing and I want to lay out how that common pattern appears and invite your response to it. It seems now, after several days of this hearing, that the pattern is this: something goes wrong in the wealth creation arm—sometimes it involves fraud and sometimes it involves selling products to people that get them into trouble—and the bank does not publicly confess. That is left up to whistleblowers or journalists. The CEO fronts up to this committee and tells us that something went wrong and they wring their hands, but back at the ranch the same people are in charge of the wealth-creation side of the business and we are left with no guarantee that it will not happen again. It seems that the problems all stem from the same source: you are inherently conflicted. The wealth management arms of your business are about making as much profit as possible, including from those who are customers in your deposit arm. My question is this: given that this pattern seems to be recurring why shouldn't we consider fixing the problem at its source and separating the deposit-taking arms from the riskier wealth-creating arms?
>
> …
>
> Mr Thorburn: … Just in closing, I think there was just one other thing that you raised that I would like to cover. That is the splitting up you talked about. My view is that we are in the business, as a bank, of looking after clients and giving them financial advice. We believe in that, we think it is really important, and we think we do it, on the whole, well. When we do not, I will be the first person to be accountable and say we need to fix that, because it is not in our best interests as a bank that we do not have the trust and confidence of our clients. But with the trends that are likely to continue—volatility in

> international markets, an ageing population and the state's lack of ability to provide pensions at the level that people desire—Australians need to save more. There is a complexity of products, and it is important that people get the right advice. I think our bank is in a very good position to do that, with the scale, the resources, the transparency, the systems and the accountability that we have in place.
>
> Mr BANDT: But at the end of the day vertical integration is the reason that you are sitting here, isn't it?
>
> Mr Thorburn: I think I am sitting here because the community, through parliament, wanted to have a conversation with us about a range of things, including funding, conduct, interest rates and a range of things that your colleagues have been asking us about today.

In fact, the banks continue to argue that no further regulation is needed, as existing forms of self-regulation suffice:

> Mr Thorburn: I think that on the planners' side it is good that it is codified and is strong and clear. If you look at the banking and finance oath you will see the commitments that have been made there are quite strong as well. I think anything where individuals volunteer to say, 'This is a code of behaviour that I believe in personally,' is the most powerful, but I do think that the steps in recent years to lift the expectations of planners and their professional qualifications are important. The disconnect from public opinion is astounding. The public deserves to know that anyone advising them on and selling them financial products does not have conflicted interests.

In the face of this approach from the big banks, it is clear that a Royal Commission is needed. This Royal Commission should examine the role of vertical integration in leading to so many people being dudded by the wealth management arms of the big four banks and also look at 'breaking up the banks' to separate retail banking from financial advice and investment banking.

At an international level, this is not radical. Both the UK and the EU are making moves to restrict and tightly regulate vertical integration.

Recommendation: That the terms of reference for a Royal Commission into banking include the nature of vertically integrated business models, including: the integration of everyday banking, financial planning, wealth management and insurance within a single entity; whether the incentives provided encourage illegal

or unethical conduct; and whether the incentives provided are aligned with the duty of care to customers.

3. Housing

Housing is increasingly out of reach of many Australians. The Household, Income and Labour Dynamics in Australia survey found that the rate of adult home ownership has dropped from 64.4 per cent in 2002 to 59.7 per cent in 2014.

The facts are particularly stark for young people. In 1990 house prices were approximately six times a young person's income, but by 2013 that had doubled to approximately 12 times a young person's income.

Yet, once again, the big banks do not seem to see a problem:

> Mr BANDT: You think housing in Sydney and Melbourne is overpriced?
>
> Mr Thorburn: No, I don't think so.

This view is unsurprising, as the hearing confirmed that growth in housing lending is a key part of the banks' maintenance of record profits.

Housing accounts for 60 per cent of the loans book of ADIs, which is very high by global standards. Growth in housing loans has averaged about 10 per cent per annum over the last twelve years, has outstripped growth in other loans over the last twelve years, and provides a good marker for the growth in profits for the big four banks.

However, not only are young people being priced out of the housing market, but the banks' love of housing poses a major risk to financial stability. The Financial Systems Inquiry (Murray Review) identified the banks' exposure to housing as one of four sources of potential systemic risk.

The growth in house prices, and the corresponding growth in bank profits and financial risk, is being underpinned by the generous tax concessions available to property investors. The strength of these incentives is being further exacerbated by the 'search for yield' in a time of record low interest rates, and the unwillingness of the government to provide an alternative investment avenue in the form of government borrowing for infrastructure.

The government cannot continue to ignore the distortionary effect of housing on the big four banks, let alone the generational wealth divide that is being created before our eyes.

Recommendation: That negative gearing for future housing purchases and capital gains tax discounts be removed, with the aim of making housing more affordable and helping shift banks' home loan profile towards owner occupiers and away from investors.

4. Other matters

The hearing explored a number of other issues, including allegations of mortgage fraud, allegations of fraud in overseas banks part-owned by an Australian bank, profits made from fees, the banks' response to climate change and whether banks pass on the benefits in cuts in their funding costs as quickly as the pass on increases. These matters will be pursued in further hearings. However, the Greens note that a House Committee inquiry offers limited opportunity to pursue these areas in the detail required, especially given the significant other matters requiring examination.

Mr Adam Bandt MP