2

Committee Recommendations to Improve the Banking System

Introduction

2.1 The committee in its first report made ten Recommendations to reform the banking sector. Each of the banks provided a response to the committee's Recommendations and they were scrutinised at the public hearings.

2.2 This chapter reviews the committee's original Recommendations in light of the responses of the banks and other information. This examination has confirmed that the Recommendations should stand and be implemented now in order to improve the Australian banking sector for the benefit of customers. The committee is open to some modest variations to the first report Recommendations but affirms the substance of each of them.

Recommendation 1

The second round of hearings with the banks focused on the Recommendations of the first report which was presented in November 2016. The committee affirms its support for all ten Recommendations of the first report.

In the committee's view each of these Recommendations should be implemented. The committee is open to some modest variations to the first report Recommendations but affirms the substance of each of them.

First Report Recommendation 1: Establish a Banking Tribunal

2.3 Recommendation 1 states:

> **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.**[1]

2.4 The reasoning and argument supporting Recommendation 1 are reproduced at Appendix 1.

Discussion

2.5 The committee is strongly of the view that consumers should be able to access a one-stop-shop for external dispute resolution with banks.

2.6 Consumers need external dispute resolution (EDR) schemes that are simple to access and are not overly legalistic. In the previous report the committee recommended that one dispute resolution body be established with the following features list below. It should:

- 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 providers) to be a member;
- operate without lawyers (to the extent possible);
- be funded directly by the financial services industry;[2]
- 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.

2.7 In December 2016, the review of the financial system external dispute resolution scheme (Ramsay Review or Ramsay) released its interim

1 House Economics Committee: *Review of the Four Major Banks: First Report*, November 2016, p. 5.

2 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.

report.[3] The Ramsay Review Interim Report draft Recommendation proposed the creation of a single industry ombudsman scheme for financial, credit and investment disputes (other than superannuation disputes).[4]

2.8 Ramsay proposed the establishment of a new industry ombudsman scheme for superannuation disputes. Ramsay noted that consideration was given to moving to a single dispute resolution scheme handling all financial system including superannuation disputes.

2.9 On balance Ramsay believed that initially it would be preferable to begin with a separate superannuation ombudsman scheme but with the future aim of combining the superannuation scheme with the financial, credit and investment dispute scheme.[5]

2.10 The committee repeats its previous conclusions that the scope of the existing schemes is inadequate. The Financial Ombudsman Service and the Credit and Investments Ombudsman 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.

2.11 In relation to this point, the committee notes that Ramsay considers that 'monetary limits and compensation caps should be higher than the current monetary limits and compensation caps of FOS and CIO.'[6]

2.12 The committee retains its view that a one-stop-shop should be established to provide straightforward redress for consumers. In the committee's view it is highly preferable to have one body dealing with these matters rather than two or more.

2.13 The committee believes that the Ramsay review should determine the precise administrative structure of this body – the key point is that it should be a one-stop-shop. It is critical that one easy to access body be established to give consumers genuine access to justice when they are wronged by a bank.

3 Review of the financial system external dispute resolution and complaints framework, *Interim Report*, 6 December 2016.

4 Ramsey Review, *Interim Report*, p. 17.

5 Ramsey Review, *Interim Report*, p. 20.

6 Ramsey Review, *Interim Report*, p. 18.

First Report Recommendation 2: Make Executives Accountable

2.14 Recommendation 2 states:

> **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.**
>
> **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.**

2.15 The reasoning and argument supporting Recommendation 2 are reproduced at Appendix 2.

2.16 The committee is not concerned if the government, in implementing the Recommendation, extends the reporting period.

Discussion

2.17 This Recommendation is essential to achieving a change in bank culture. Senior bank executives must take responsibility for failures in their divisions. This does not occur now.

2.18 The NAB, CBA and Westpac indicated that the five business day reporting timeframe was too short and that natural justice could be compromised if an investigation is rushed.

2.19 It is important to note that the Recommendation is that the public report should be made within five days of the breach being reported to ASIC – not that it be made within five days of the breach occurring.

2.20 Nevertheless, the committee is prepared to accept more time may be appropriate in certain circumstances.

2.21 NAB, CBA and Westpac, under scrutiny, would not agree to this Recommendation.

2.22 The CBA stated that 'we believe it could be a breach of natural justice to 'name and shame' individuals before taking adequate time to properly investigate the alleged breaches.'[7]

2.23 As an alternative to reporting of specific breaches, Westpac noted that 'we report the outcomes for our group executives at the end of the year in a fairly fulsome disclosure in our annual report every year.'[8]

2.24 The NAB stated that 'public reporting may also act as a disincentive to report breaches unless strictly required, or may require a 'legalistic' view on what is reported.'[9] This argument reflects poorly on NAB as it appears to suggest that the bank believes that its staff may not follow legally binding rules.

2.25 In contrast, the ANZ noted that it largely supported the Recommendation and stated:

> AFSL holders could feasibly issue a public report that includes a description of the breach and how it occurred, the steps taken to ensure it does not reoccur and the senior executive responsible for the relevant business. Because the report would be issued soon after the breach report, it would, like those reports, be based on preliminary rather than conclusive findings.[10]

2.26 The ANZ noted that Section 912D of the *Corporations Act 2001* (the Act) is not crafted as a trigger for individual culpability. Instead, the ANZ proposed the possibility of inserting a new accountability provision into the Act which 'could recognise the circumstances in which individual executives should suffer personal consequences for serious failures of the AFSL holder to comply with the law.'[11]

2.27 The ANZ demonstrated a more constructive attitude in relation to Recommendation 2. In addition to the CEO, ANZ was represented at the hearing by Ms Alexis George, Group Executive for Wealth Australia, ANZ. Wealth management arms of the banks are where recent significant breaches occurred.

2.28 Ms George was asked specifically how she would react to the possibility of being named in a breach report. Ms George, to her credit, stated:

> We have obviously discussed this recommendation, and I am sure it is not something my children would be proud of to have me named and shamed, but I think it is appropriate that this be at the

7 CBA, Correspondence, 2 March 2017.

8 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 7 March 2017, p. 4.

9 NAB, Correspondence, 1 March 2017.

10 ANZ, Correspondence, 6 March 2017.

11 ANZ, Correspondence, 6 March 2017.

> executive level, and I understand why the committee is asking for this. At the management level of shame, we all understand that we need to rebuild trust in the community, and, as a result, as a senior executive responsible for wealth, I am happy to take that.[12]

2.29 Recommendation 2 proposes an effective measure to introduce real executive accountability in the banks. Importantly, the Recommendation would apply to CEO-reporting executives, who have the greatest capacity to change bank culture.

2.30 The committee affirms Recommendation 2.

First Report Recommendation 3: Require New Focus on Banking Competition

2.31 Recommendation 3 states:

> **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.**
>
> **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.**

2.32 The reasoning and argument supporting Recommendation 3 are reproduced at Appendix 3.

Discussion

2.33 The NAB, CBA and Westpac all noted that they support measures that encourage competition. However, they stopped short of supporting this Recommendation because Recommendation 30 of the Financial Services Inquiry (FSI) proposed that competition in the financial sector be reviewed every three years.[13]

2.34 FSI Recommendation 30 stated:

> Review the state of competition in the sector every three years, improve reporting of how regulators balance competition against their core objectives, identify barriers to cross-border provision of

12 Ms Alexis George, Group Executive, Wealth, ANZ, *Transcript*, 7 March 2017, p. 73.

13 Financial System Inquiry, *Final Report*, November 2014, p. xxvi.

> financial services and include consideration of competition in ASIC's mandate.[14]

2.35 The Government agreed with this Recommendation and proposed that:

> We will task the Productivity Commission to review the state of competition in the financial system by the end of 2017, three years after the completion of the Inquiry. Subsequent periodic reviews will be undertaken as appropriate. We support inclusion of competition in ASIC's mandate and we will develop legislation to introduce an explicit reference to consideration of competition in ASIC's mandate in the second half of 2016.[15]

2.36 In the first report the committee noted and endorsed the work of the Productivity Commission (PC) in periodically reviewing financial sector competition. However, the committee noted that it does not believe that structural reviews undertaken 'as appropriate' go far enough. The committee reaffirms this conclusion.

2.37 It is essential that the ACCC establish a small team dedicated to continual monitoring of competition in the banking sector and reporting to the Treasurer every six months.

2.38 The ANZ agreed with Recommendation 3 noting that 'analysis from a government agency would help demonstrate the nature and level of competition.'[16]

2.39 It is highly regrettable that the other banks do not support this Recommendation, given that they argue that competition in the sector is essentially perfect now. The intention of the Recommendations is to ensure competitive issues in the industry are thoroughly scrutinised and this should be welcomed by the banks.

2.40 The committee affirms Recommendation 3 and believes it should be implemented for the reasons outlined in the first report.

First Report Recommendations 4 and 5: Empower Consumers

2.41 Recommendation 4 states:

> **The committee recommends that Deposit Product Providers be forced to provide open access to customer and small business**

14 Financial System Inquiry, *Final Report*, November 2014, p. xxvi.

15 Improving Australia's Financial System, *Government Response to the Financial System Inquiry,* 20 October 2015, p, 24.

16 ANZ, Correspondence, 6 March 2017.

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.

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

2.42 The reasoning and argument supporting Recommendations 4 and 5 are reproduced at Appendix 4.

Discussion

2.43 All four banks expressed general support for data sharing. However, the committee tested them on how strongly they supported this Recommendation taking into account the fact that customer data is currently a proprietary asset. This creates a conflict as the process of opening up data will lead to the asset being shared with other financial services companies.

2.44 This is why an independent regulator must lead the change and be responsible for implementation. The process of introducing data sharing cannot be left to the banks to lead.

2.45 During the hearings, all banks warned that it was essential to ensure that consumer data was protected and that the privacy of individuals was paramount. Westpac noted that 'a significant data breach under any open data regime could result in large scale identify theft and the loss of trust in payment system integrity.'[17]

2.46 The CBA stated:

> To be clear on this, we will support any solution if, ultimately, we can be very clear who is specifically accountable for privacy and security. That will need to be clear. We want to take that accountability and, if somebody else is going to take it, be accountable for that so we know where to address concerns if there are problems with this. We are open to that solution.[18]

2.47 Privacy and security of consumer data is a priority for the committee. That is why Recommendation 4 states that 'ASIC should be required to develop a binding framework to facilitate this sharing of data, making use of

17 Westpac, Correspondence, 7 March 2017.

18 Mr Ian Narev, CEO, CBA, *Transcript,* 7 March 2017, p. 8.

Application Programming Interfaces (APIs) and ensuring that appropriate privacy safe guards are in place.'

2.48 The committee affirms Recommendation 4 and emphasises that ASIC or another independent regulatory body must lead the change process. The banks are conflicted in this process and must not be allowed to lead it.

2.49 Recommendation 5 states:

> **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.**

2.50 All banks indicated that they were supportive of account switching tools to improve competition. The banks noted that on 9 March 2017 the ABA was holding a switching summit with consumer groups, government representatives and the credit card schemes. The ABA stated:

> …at the last hearings of this committee there was a lot of discussion about the ability of customers to move between banks—to switch banks. As a direct consequence of that, tomorrow we have a full-day round table with the industry, consumer groups, community organisations, the regulators, government departments, the credit card schemes and other participants to drill down and understand what the problems are that customers have in switching banks. So, that is a direct link to the October hearings, yes.[19]

2.51 The committee affirms Recommendation 5.

First Report Recommendation 6: Make it Easier for New Banking Entrants

2.52 Recommendation 6 states:

> **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**

19 Mr Steven Münchenberg, CEO, ABA, *Transcript*, 8 March 2017, p. 48.

'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.**

2.53 The reasoning and argument supporting Recommendation 6 are reproduced at Appendix 5.

2.54 All banks broadly supported this Recommendation noting that ultimately this is a decision for government.

2.55 The committee affirms Recommendation 6.

First Report Recommendation 7: Force Independent Reviews of Risk Management Systems

2.56 Recommendation 7 states:

> **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.**

2.57 The reasoning and argument supporting Recommendation 7 are reproduced at Appendix 6.

Discussion

2.58 The committee drafted this Recommendation with a focus on achieving better outcomes for customers by ensuring that banks regularly review their risk management frameworks so as to better identify and respond to misconduct.

2.59 Each of the banks has responded claiming that APRA Prudential Standard CPS 220 performs this function. The background to CPS 220 is outlined below:

- CPS 220 is a cross industry standard intended to cover the material risks as identified by the entity's Board.
- CPS 220 commenced in January 2015 and entities (including ADIs) are currently in the process of completing the triennial risk reviews required under the standard.
- It is a risk management framework approach intended to cover the whole of the entity's operations.

- From a prudential perspective, CPS 220 is complemented by governance standards, including Fit and Proper requirements for senior management.

2.60 The ANZ stated:

> APRA Prudential Standard CPS 220 requires banks to have at least annual reviews of risk management frameworks by internal and or external audit. The standard also requires a comprehensive independent review of risk management frameworks at least every three years. We believe the current prudential requirement is significant and should remain. A further independent review would duplicate this existing regulatory requirement.[20]

2.61 The NAB commented that the 'Government could achieve the substance of Recommendation 7 by asking the banks to provide the conduct risk sections of these CPS 220 reviews to APRA.'[21]

2.62 The committee does not agree that the CPS 220 risk management review process is sufficient in relation to misconduct. CPS 220 has a broad focus on the material risks to a bank. While these objectives are important for prudential reasons the committee's focus in this Recommendation is the ongoing and serious nature of misconduct by the banks towards their customers.

2.63 The committee's Recommendation will ensure that the banks give top priority to developing a risk management framework that truly puts customers first. This risk management review should work in parallel to CPS 220.

2.64 In the March hearings numerous recent reports of unacceptable conduct by the banks were raised by committee members. For example, in February 2017 ASIC reported that NAB had been forced to pay $35 million in compensation after overcharging 220,000 superannuation accounts.

2.65 On 17 December 2016 it was reported that the NAB mistakenly sent information such as names, addresses and banking details of 60,000 migrant banking customers to a wrong email account.

2.66 On 6 December 2016 it was reported that the CBA provided a further $5 million in compensation to victims of poor financial advice, as a forensic review of the redress scheme found instances where the bank's Financial Planning and Financial Wisdom businesses failed to act within required timeframes. On 7 February 2017 CBA announced that all file

20 ANZ, Correspondence, 6 March 2017.

21 NAB, Correspondence, 1 March 2017.

assessments had been completed and $23 million would be offered in compensation to victims of poor financial advice.

2.67 In relation to ANZ it was reported in December that close to $50 million had been charged to clients in the wealth management division for services that were not in fact received.

2.68 In relation to Westpac it was noted during the hearing that:

> …in September you were refunding over 800,000 clients about $20 million for inappropriate fees on credit cards pertaining to foreign exchange fees. In October you acknowledge that your division had a 37 per cent rejection rate on claims in the total and permanent disability category of life insurance, which was the highest of any insurers investigated by ASIC. In November you had one of your financial planners, Anthony Bishop, banned for eight years for giving inappropriate advice to your clients between 2010 and 2014. In December ASIC said it was taking legal action against you for providing inappropriate advice in the process of selling products in your wealth management division, through BT in particular. In February ASIC alleged that you were providing loans to borrowers without actually checking adequately whether they could pay back those loans, and ASIC is now pursuing legal action against you in relation to that. In addition to that, later this year ASIC will be pursuing action against you in relation to the alleged rigging of the bank bill swap rate. So it is quite a significant list of allegations…[22]

2.69 The committee affirms Recommendation 7 and believes that an independent review of banks' risk management frameworks aimed at improving how the banks identify and respond to misconduct is essential. The risks that can damage customers must be identified and reduced.

2.70 The committee therefore affirms Recommendation 7.

First Report Recommendation 8: Improve Internal Dispute Resolution Schemes

2.71 Recommendation 8 states:

> **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:**

22 Mr David Coleman, Chair, *Transcript*, 8 March 2017, p. 2.

- **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.**

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.

2.72 The reasoning and argument supporting Recommendation 8 are reproduced at Appendix 7.

Discussion

2.73 All banks agree with this Recommendation. The NAB noted that it currently provides similar information on its IDR activity for Code of Banking Practice related disputes to the Code Compliance Monitoring Committee (CCMC). NAB commented that 'the design of further reporting obligations should take into account, and seek to utilise where possible, the existing reporting to the CCMC.'[23]

2.74 Westpac noted that it did not believe that legislative amendment was required to implement the Recommendation as ASIC already has the power to collect data on IDR arrangements and take action where an institution is not complying with ASIC's requirements.[24]

2.75 The committee affirms Recommendation 8.

First Report Recommendations 9 and 10: Boost Transparency in Wealth Management

2.76 Recommendation 9 states:

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**

23 NAB, Correspondence, 1 March 2017.

24 Westpac, Correspondence, 7 March 2017.

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.**

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

2.77 The reasoning and argument supporting Recommendations 9 and 10 are reproduced at Appendix 8.

Discussion

2.78 The ANZ, CBA and Westpac all indicated that they support this Recommendation. The ANZ commented that 'we support measures like this which help consumers regain trust in the wealth management industry.'[25]

2.79 The CBA noted that 'we already advise clients of an advisor under certain circumstances.' The CBA cautioned that 'we believe that reporting on minor breaches could cause confusion and negatively impact confidence in the system.'[26]

2.80 Westpac commented that 'a report on the wealth management industry, which presents reliable and comparable information based on standardised reporting templates and definitions, will improve transparency on any issues in the sector and enable comparison between participants.'[27]

2.81 In contrast, the NAB did not support the reporting regime as proposed by this Recommendation stating:

> Extending a report beyond settled prosecutions is procedurally unfair if cases are still being heard or considered by regulators. NAB believes that qualitative terms such as 'quality of advice' and 'misconduct' are not sufficiently defined metrics for the regulator to report on.
>
> As an alternative, NAB suggests an annual report on AFSL data such as complaints, levels of compensation, EDR statistics and the number of banned or formally sanctioned advisers.[28]

25 ANZ, Correspondence, 6 March 2017.

26 CBA, Correspondence, 2 March 2017.

27 Westpac, Correspondence, 7 March 2017.

28 NAB, Correspondence, 1 March 2017.

2.82 The committee rejects NAB's position.

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

2.84 In the first report the committee noted that poor financial advice has resulted in the CBA and NAB alone paying out approximately $85 million in compensation since 2009. Wealth management divisions of banks have been involved in misconduct far too often.

2.85 The committee affirms Recommendation 9.

2.86 Recommendation 10 states:

> **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.**

2.87 All banks broadly support this Recommendation but noted that some lower level breaches may not warrant reporting. The ANZ advised that it has already put in place a process to write to an advisor's former clients if they are banned by ASIC but cautioned that:

> Our only concern with the recommendation is that some legal breaches are minor and/or inadvertent. These wouldn't need to be reported to ASIC as they are not 'significant'. We think there should be a sensible threshold before licence holders need to contact clients. This is primarily to avoid unnecessary alarm.[29]

2.88 Similarly, Westpac commented that:

> In implementing this recommendation, it would be important to set an appropriate materiality threshold that would trigger a requirement for notification to the client. We do not believe that clients would wish to be notified of administrative breaches that do not adversely impact on the quality of advice they received.[30]

2.89 Similarly, the CBA did 'not support the process for minor breaches, which could cause confusion and further impact confidence in the system.'[31]

2.90 NAB noted that it supports a requirement for licensees to take appropriate steps to contact all clients where an advisor has been banned by ASIC. However, NAB stated that 'deciding on whether to contact all clients

29 ANZ, Correspondence, 6 March 2017.

30 Westpac, Correspondence, 7 March 2017.

31 CBA, Correspondence, 2 March 2017.

should be assessed on a case by case basis, applying standard remediation protocols and ASIC regulatory guidance.'[32]

2.91 The committee is not persuaded by these arguments and similar points were dealt with in the first report. The committee concluded that irrespective of whether a customer has suffered financial harm they have a right to know if they have been advised by someone that has been found guilty of misconduct.

2.92 The committee affirms Recommendation 10.

32 NAB, Correspondence, 1 March 2017.