3

Key issues at public hearings

Executive accountability and the BEAR

3.1 During the public hearings with the major banks, numerous cases of misconduct were raised, including:

- The Australian Securities and Investment Commission's (ASIC) civil penalty proceedings against Australia and New Zealand Banking Group (ANZ), Westpac and National Australia Bank (NAB), respectively, alleging market manipulation and unconscionable conduct in setting the Bank Bill Swap Rate (BBSW);[1]
- Financial planners at NAB falsely witnessing loan documents;[2] and
- A case involving Mr Sudhir Kumar Sinha, who was a financial planner for Westpac and has been banned by ASIC from providing financial services until 2022. Mr Sinha wrongfully advised 177 clients over a period of six years.[3]

3.2 In each case, the banks were asked if any senior executives had been held to account. The banks indicated that executives had faced repercussions, where appropriate. However, there were very few cases where senior executives had been terminated. Instead, repercussions largely related to career progression.

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1 Australian Securities and Investment Commission (ASIC), '16-183MR ASIC commences civil penalty proceedings against National Australia Bank for BBSW conduct', *Media Release,* 7 June 2016.

2 See, for example, Sydney Morning Herald, *NAB faces fresh misconduct claims over false witnessing*, 27 May 2017, <http://www.smh.com.au/business/banking-and-finance/nab-faces-fresh-misconduct-claims-over-false-witnessing-20170524-gwcnfn.html>, viewed 17 November 2017.

3 ASIC, '17-178MR ASIC bans former Westpac advisor for five years', *Media Release,* 8 June 2017.

3.3 Within this context, the banks' view on the Bank Executive Accountability Regime (BEAR) was sought. The BEAR will make senior bank executives more accountable and subject to additional oversight by APRA.

3.4 The BEAR was announced in the 2017 Budget in response to this committee's recommendations to improve accountability and transparency within financial institutions.

3.5 Under the BEAR, senior executives and directors of all authorised deposit-taking institutions (ADIs) will be required to be registered with APRA. This will enable APRA to scrutinise all senior appointments, and if senior executives have not met expectations they will no longer be able to be registered or employed in senior roles.

3.6 ADIs will need to provide APRA with accountability maps of the roles and responsibilities of their senior executives. This will enable greater scrutiny at the time of each person's appointment and oversight of problems that emerge under their management.

3.7 The Government will be introducing a new civil penalty with a maximum fine of $200 million for the big banks, and $50 million for smaller ADIs that fail to meet their new obligations. APRA will also be able to impose penalties on ADIs that do not appropriately monitor the suitability of their executives to hold senior positions.[4]

3.8 The banks accepted the introduction of the BEAR, with some expressing support for the regime, particularly the accountability mapping component. The banks made the following observations on the BEAR:

> [CBA] In my opening statement I said we were supportive of the BEAR regime in the context of the accountability aspect of it.[5]
>
> [Westpac] What the BEAR is emphasising—which I think is a really good point—is that we need to make sure it is crystal clear who is accountable for each aspect of supervision, and this will drive that.[6]
>
> [NAB] We accept the BEAR. It's going to be passed; we accept that. I think it's a very important process.[7]
>
> [ANZ] Look, I wish we didn't need a BEAR. We shouldn't need one. We shouldn't need regulation to keep us operating ourselves well, but I understand the need for it. We are improving, we're

4 The Treasury, 'Banking and Financial services: a more accountable and competitive banking system', *Budget 2017 Fact Sheet*, May 2017.

5 Ms Catherine Livingstone, Chairman, Commonwealth Bank of Australia (CBA), *Transcript*, 20 October 2017, p. 66.

6 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 3.

7 Mr Andrew Thorburn, CEO, National Australia Bank (NAB), *Transcript*, 20 October 2017, p. 19.

> focused on doing the right thing and, again, as I said, I think we should be proud of the system that we have.[8]

3.9 Some banks advised that they were already beginning to implement the regime. CBA stated that it is currently undertaking accountability mapping within the organisation.[9]

3.10 Westpac said that while the legislation had not yet passed, it had begun implementation and is reviewing its 'incentive systems to ensure they align with the BEAR rules'.[10]

Credit card interest rates

3.11 A consistent theme of the inquiry has been the need for greater price competition in the credit card market. Recent decisions by ANZ, CBA and Westpac in relation to credit cards are a positive step, in particular:

- ANZ reducing the interest rate on its Low Rate Platinum card by 2 per cent p.a. to 11.49 per cent p.a., and on its Low Rate Classic card by 1 per cent p.a. to 12.49 per cent p.a.[11]
- CBA introducing a new credit card with an interest rate of 9.9 per cent p.a.[12]
- Westpac introducing a new credit card with an interest rate of 9.9 per cent p.a.[13]

3.12 The banks were asked if they had seen significant uptake of these products. Westpac said that the response to its new product had been positive:

> It's been well received as an option and an initiative by a number of clients. We've already had several thousand people take out the card, but the promotion of it is still in the early stages.[14]

3.13 By contrast, ANZ said the uptake of its new low rate products had been modest. ANZ claimed that most customers focus on the annual fees and

8 Mr Shane Elliott, CEO, Australia and New Zealand Banking Group (ANZ), *Transcript*, 11 October 2017, p. 70.

9 Ms Catherine Livingstone, Chairman, CBA, *Transcript*, 20 October 2017, p. 66.

10 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 2.

11 ANZ, 'ANZ reduces credit card rates to lowest since 2003', *Media release*, 19 February 2017.

12 CBA, 'Commbank to launch new credit card with an interest rate below 10% and real-time alerts for credit card repayments and overdrawn accounts', *Media release*, 11 October 2017.

13 Westpac, 'Westpac introduces new credit card with lowest interest rate currently offered by a major Australian bank', *Media release*, 30 June 2017.

14 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 28.

rewards instead of the interest rate, largely because most customers do not intend to borrow on credit cards:

> The reality is that when people come and apply for a card, a lot of them don't imagine they will be borrowing. And the interest rate, interestingly, is not the primary driver of what they're interested in. The annual fee is really important, and they do think about rewards and other things.[15]

3.14 In terms of offering customers flexibility, Westpac noted it had designed a new product called SmartPlan. This product allows customers to allocate a particular purchase or a particular amount and put it onto an instalment line at a lower rate.

3.15 Given the decisions of ANZ, CBA and Westpac, NAB's inaction on credit cards is notable. NAB was asked why it was able to remove ATM fees but not lower credit rates after competitors changed their offerings. In response, NAB claimed its rates are continually under review, and that its products continue to be competitive. NAB stated:

> My commitment today is that we are going to have competitive rates, and that rate is competitive. It's a value product. It's under review, just like all our products and services.[16]

Small business reforms

3.16 In April 2017, this committee endorsed the findings of the Australian Small Business and Family Enterprise Ombudsman's inquiry into small business loans (the Carnell Report) and recommended that non-monetary default clauses be abolished for loans to small businesses.

3.17 The major banks have historically held immense power over small business borrowers through complex, one-sided loan contracts. For example, non-monetary default clauses and covenants in contracts allow banks to trigger the default of a business loan if risk factors change, even when the borrower has kept up payments on their loan.

3.18 In relation to non-monetary default clauses, Recommendation 3 of the Carnell Report states:

> For all loans below $5 million, where a small business has complied with loan payment requirements and has acted lawfully,

15 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, pp. 55-56.

16 Mr Andrew Thorburn, CEO, NAB, *Transcript*, 20 October 2017, p. 26.

> the bank must not default a loan for any reason. Any conditions must be removed where banks can unilaterally:
>
> - value existing security assets during the life of the loan
> - invoke financial covenants or catch-all 'material adverse change' clauses.
>
> Implementation by 1 July 2017.[17]

3.19 Non-monetary default clauses offend basic principles of fairness. If a small business has done the right thing and made all payments to their bank on time and in full, a bank should not be allowed to default that borrower.

3.20 In response to the recommendations of the Carnell Report and the ongoing work of this committee, all banks confirmed they have removed 'material adverse change' clauses as well as financial indicator covenants for loans up to $3 million in value.

3.21 During the hearings, the banks stated that while some non-monetary covenants remained, these largely relate to the probity of the customer.

3.22 Given the Carnell inquiry recommended non-monetary covenants be removed for loans up to $5 million, the banks were asked why they had chosen $3 million as the threshold. The banks claimed that loans above $3 million in value are significantly more complex and that removing non-monetary covenants for these loans would affect the price and availability of credit. Further, that loans up to $3 million in value cover up to 99 per cent of business customers.[18] ANZ stated:

> The reason is once you get beyond that certain size you start to get into more complex legal situations for the companies. Essentially, they are both more complex, they are likely to have these structures and actually it means we need more protection. If we don't have that protection for these larger borrowings, clearly either there will be a higher cost of credit or the availability of credit will be affected by that.[19]

3.23 The banks were asked if they were considering changes to loans beyond $3 million in value. The banks indicated the threshold of $3 million was final for now. However, some banks suggested that they may be able to increase the threshold as technology improves. In particular, ANZ stated:

> I think the industry has gone through this in quite a lot of detail. I know there has been a good debate with the ombudsman around

17 Australian Small Business and Family Enterprise Ombudsman, *Inquiry into small business loans*, 12 December 2016, Recommendation 3, p. 7.

18 Mr Graham Hodges, Deputy CEO, ANZ, *Transcript*, 11 October 2017, p. 51.

19 Mr Graham Hodges, Deputy CEO, ANZ, *Transcript*, 11 October 2017, p. 51.

> this. I think as we get further benefits from technology over time, we might see that change. But, right now, I think the industry feels that is the right level.[20]

3.24 An update on progress to deliver simpler small business contracts was sought. All banks claimed they were committed to implementing the Carnell Report recommendations relating to small business contracts and were finalising a simplified code of banking practice by the end of the year.

3.25 The Carnell Report recommended the banks act to balance their unfair relationship with small business borrowers, manifested in:

- extremely complex, one-sided contracts that yield maximum power to banks to make unilateral changes whenever they like and without the agreement of borrowers
- inadequate timeframes around key loan milestones that leave borrowers vulnerable
- misleading and conflicting signals between bank sales staff and credit risk staff which leaves borrowers vulnerable
- lack of transparency and potential conflict of interest in dealings with third parties involved in impaired loan processes, such as valuers, investigative accountants and receivers
- significant gaps in access to justice with nowhere to go except the court system, with borrowers having limited resources and banks having overwhelming resources.[21]

3.26 The Carnell Report noted that the code of banking practice is self-regulated, and written in legal terms from the banks' perspective with small business mixed-in with consumers. It recommended the code be revised to include a dedicated small business section, simplify the language, and to remove caveats that enable bank discretion to decide not to adhere to clauses.[22] The Carnell Report recommends that, once revised, the code of banking practice be approved under ASIC's Regulatory Guide 183.[23]

3.27 In relation to the revised code of banking practice, Westpac commented 'the general point is to make it simpler, plain English and provide more protections for customers'.[24] Similarly, ANZ said it was looking to publish

20 Mr Graham Hodges, Deputy CEO, ANZ, *Transcript*, 11 October 2017, p. 51.

21 Australian Small Business and Family Enterprise Ombudsman, *Inquiry into small business loans*, 12 December 2016, p. 6.

22 Australian Small Business and Family Enterprise Ombudsman, *Inquiry into small business loans*, 12 December 2016, p. 16.

23 Australian Small Business and Family Enterprise Ombudsman, *Inquiry into small business loans*, 12 December 2016, p. 20.

24 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 32

the code online, to include a search function, and to enable small businesses to access a targeted view that, 'if you go in as a small business, it will bring up the clauses in the code which are relevant to you as opposed to the whole thing'.[25]

3.28 NAB indicated that it had rolled out its new contracts, which are in simple plain English and have reduced terms and conditions by a third. NAB claimed that these changes will benefit 130,000 businesses, representing 98 per cent of its business customers.

ATM fees

3.29 In September 2017 the CBA announced it had scrapped the two dollar transaction fee imposed on non-CBA customers withdrawing money from its ATMs. The other banks quickly followed suit.

3.30 The banks were scrutinised on their decisions to remove ATM fees charged to customers of other banks. The banks stated that the decision was to address community concerns. Westpac stated:

> It is something that we had looked at over the last couple of years. We are aware of community issues that have been raised and customer feedback in the media and directly on different types of fees.[26]

3.31 Similarly, the ANZ noted that customers were concerned about ATM fees, stating:

> In most capital cities we talked to customers and also conducted a lot of research trying to understand what issues were out there. Frankly, I was surprised that, top of the list, the number one issue that people raised was these ATM fees.[27]

3.32 The banks were questioned on a proposed 'utility' model in which they would cooperate to provide joint ATMs that would be mutually funded and maintained.

3.33 The banks stated they had considered this issue in recent years. Further, ANZ and NAB said that they had been actively working on an industry utility model as an alternative to the approach taken by CBA. ANZ stated:

> We did the ground work on that [utility model], spoke to some of our peers and tried to get an industry solution to get a better way

25 Mr Graham Hodges, Deputy CEO, ANZ, *Transcript*, 11 October 2017, p. 52.

26 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 21.

27 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 52.

> to eliminate these fees. We were working heavily on that. In fact we had to engage with the ACCC to make sure that everything was going to be done on a legitimate basis. We had done the work and were pretty close to pushing the button on that when CBA made their announcement. So we followed. We didn't want our customers or our network to be left behind, so we acted.[28]

3.34 ANZ and NAB suggested that they would continue to work on the utility model as a more efficient long-term solution. In particular, ANZ indicated:

> …there's an opportunity for that, which is a better outcome for customers. We could end up with better ATM access across the country, and shared. So we're still working on that.[29]

3.35 In contrast, the CEO of the CBA stated he had not considered a utility model proposal, nor had he discussed this with the other banks.[30]

3.36 Given the removal of fees, there are legitimate concerns this would result in ATMs being removed, particularly from regional and remote communities. The banks acknowledged there would likely be a removal of some ATMs as a consequence. For example, ANZ stated:

> It's absolutely reasonable and sensible that you would expect, as a result of this—the utility, or value, of those things has fallen—that there will probably be fewer ATMs in the country as a result. What we've got to make sure of is that there's still a decent footprint that services customers' needs.[31]

3.37 The banks were asked whether an additional motive for the decision was to put third-party providers of ATMs out of business. The banks rejected this assertion, and claimed it was not a part of their discussions. ANZ stated:

> No. Honestly—and, again, you're welcome to look at our own papers on that—that [putting third party provider out of business] wasn't even discussed in any of the proposals we looked at.[32]

Bank branch and employee numbers

3.38 The banks were scrutinised on the likely impact of technology on staffing levels, given that employee numbers have declined significantly in recent

28 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, pp. 52-53.

29 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 53.

30 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 62.

31 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 53.

32 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 54.

years.[33] The banks argued that while technology was likely to replace some jobs, it will also create new jobs.[34]

3.39 ANZ claimed that the job losses would likely be concentrated in areas which involved manual processes such as data entry, rather than customer facing roles.[35]

3.40 The banks stated that they would help employees transition into new roles. For example, Westpac stated:

> We recognise it is a real issue for the company and we have been spending a lot more money investing in our people's skills and in the ability to create work that's more flexible and to help people move around and try different things.[36]

3.41 Concerns were raised with the banks about the future of bank branches, particularly in rural and remote areas. The banks acknowledged there had been a number of branch closures in recent years and that this was likely to continue to some degree. The banks claimed this was in response to changing customer preferences. For example, in rural areas, the banks claimed branch closures were a result of migration towards metropolitan areas and customers choosing to bank in regional hubs. ANZ stated:

> The reality is: why are we closing branches? It is because our customers have already made the decision for us because they no longer come to the branch…If they are, they are tending to go into regional towns—the Ballarats of the world et cetera.[37]

3.42 Under scrutiny on the impact of closing branches in regional areas, Westpac stated:

> We're very conscious of the concerns in regional Australia around branches, and that is why, as part of the changes we have made in our branches, we have made an arrangement with Australia Post that has opened up 3,500 new locations all over the country where people can do their transactions. We have also put videoconferencing capabilities into many of our regional branches—in fact, all branches now have videoconferencing. A customer can go into a regional branch and talk live to a

33 R. Williams, 'Job-killers: bank workers at forefront of "massive disruption"', *Sydney Morning Herald*, 3 November 2017.

34 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 17.

35 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 64.

36 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 17.

37 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 48.

> specialist financial planner, a mortgage specialist, whatever it might be.[38]

Remuneration policies and incentives

3.43 There is community concern that the banks have historically prioritised sales over customer service, and that this culture has been institutionalised through employee remuneration policies and incentives.[39] The banks acknowledged this concern, yet they all claimed that providing good customer service was now their first priority. For example, Westpac stated:

> Our philosophy at Westpac—I can't speak for the others—is: we are trying to grow our business by growing the number of customers who entrust their banking and their life savings and investments with us. To do that, we need to deal with them as if we're going to bank them forever. That means that the decisions need to be free of conflicts of interest, that our people are focused very much on the quality of service they provide and that the advice and recommendations that they give them are in the best long-term interests of those customers.[40]

3.44 The Sedgwick review examined the arrangements around incentives, commissions and bonus payments for retail staff of banks as well as third parties such as brokers. It found that:

> …some current practices carry an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers and should therefore be changed. Some of these relate to management practices that may reduce the effectiveness of the bank's risk mitigation strategies. Other practices relate to the way incentives and remuneration are structured.[41]

3.45 Within this context, an update was sought on implementation of recommendations from the Sedgwick review of product-based remuneration. The banks stated they had agreed to all 21 recommendations and were already progressing implementation.

3.46 The banks stated that they had changed their remuneration scorecards as a result of the Sedgwick review. For example, NAB said they had lowered

38 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 18.

39 Mr Stephen Sedgwick AO, *Retail Banking Remuneration Review Report*, 19 April 2017, p. 12.

40 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 25.

41 Mr Stephen Sedgwick AO, *Retail Banking Remuneration Review Report*, 19 April 2017, p. 4.

the proportion of pay that could be at risk to 25 per cent, and that branch managers, assistant branch managers and team leaders in call centres no longer have product-based incentives.[42]

3.47 The banks also stated that the recommendation relating to mortgage broker remuneration presented the greatest challenge because it involved third-parties. However, they committed to work through the issue with industry. ANZ stated:

> The one that's the most complicated is around third-party brokers, basically. The only reason for that is that it's hard for us to do it unilaterally. But we're working really hard with the industry, through the ABA, with our peers, and with the broking industry, to get that done.[43]

Foreign exchange transactions

3.48 Noting a recent article in *The Australian*,[44] banks were asked to explain the cost of foreign exchange transactions, in particular why these transactions tended to be more expensive in Australia than other nations. The banks claimed that the numbers quoted were not correct. Further, the banks claimed the article was not comparing like products. ANZ stated:

> They don't reconcile with what our customers experience at ANZ … I haven't seen where they got their data from, but I think they're comparing apples and oranges in that review.[45]

3.49 The banks were asked to explain why they charge both a transaction fee as well as a margin on the exchange rate, and why they did not advertise the margin. In response, the banks claimed the price consumers pay on foreign exchange transactions was already very transparent. ANZ stated:

> A customer will know with certainty what the rate they are getting, in terms of the transfer... You can go online and in literally seconds find out what the currency rates are, what the midrate is—like a wholesale price—and where there are different providers.[46]

42 Mr Andrew Thorburn, CEO, NAB, *Transcript*, 20 October 2017, p. 35.

43 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 49.

44 Article: Adam Creighton, ‘The big four banks reap billions in fees’, *The Australian*, 2 October 2017.

45 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 67.

46 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 67.

3.50 NAB said it will charge one upfront fee and that it would absorb any fees subsequently charged by foreign banks. NAB claimed that, in addition to the fee structure being simplified, its fee will be significantly lower:

> In terms of the fee that we charge for one of our digital channels, we'll basically be looking to halve the fee that we charge. On top of that, as Andrew said, we will be absorbing any fees that are being charged by offshore banks as well, so it will be a significant reduction for most customers in relation to fees.[47]

3.51 NAB said that it made these changes to ensure they remained competitive, particularly with respect to its business customers:

> We're Australia's largest business bank. As we see consumers and businesses continue to trade offshore and we're seeing more volume going through, we want to ensure we're really competitive. We want to give our customers the best products and services.[48]

Coal industry lending practices

3.52 The banks were asked to outline their policies relating to coal industry lending.

3.53 CBA explained that its considerations on lending were not 'purely financial' and that projects must be 'fully compliant with our environmental policy'.[49]

3.54 ANZ stated it would only consider financing new coal fired power plants if emissions were reduced to at least 0.8 tC02/MWh.[50]

3.55 Westpac stated that the climate policy it released this year would limit the financing of coalmining to 'the highest quality of coal, where the calorific value of the coal being produced was in the top 15 per cent'. Westpac added that it would also 'not support the development of new coal basins but we would—subject to the quality of the coal being okay—support expansion in existing basins'.[51]

3.56 NAB was asked about its decision to release a press statement indicating it would not lend to the Carmichael coalmine. When asked if NAB had been approached for funds for the mine, the NAB CEO advised that he did not

47 Mr Antony Cahill, Chief Operation Officer (COO), NAB, *Transcript*, 20 October 2017, p. 16.

48 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 16.

49 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 74.

50 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 65.

51 Mr Brian Hartzer, CEO, Westpac, *Transcript*, 11 October 2017, p. 29.

think so. Further, NAB was asked whether a statement of this nature would affect the company’s ability to borrow money elsewhere. NAB acknowledged that it would and that this is why it clarified that it will not make any references to clients or projects in the future.

3.57 Similarly, CBA was asked to explain why it released a press statement on its decision not to lend to the Carmichael coalmine. CBA noted that the statement was released in response to a question, and noted that Adani have themselves stated they will not be seeking funds from the CBA for the mine.

David Coleman MP
Chair
6 December 2017