
The Parliament of the Commonwealth of Australia

Review of the Four Major Banks (Third Report)

House of Representatives
Standing Committee on Economics

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Canberra

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Chair's foreword

Since the House of Representatives Standing Committee on Economics commenced its inquiry into Australia's four major banks in October 2016, the Government has announced significant reforms to the banking and financial sector to implement the committee's recommendations.

In the 2017 Budget, the Treasurer announced the Government would be broadly adopting nine of the committee's 10 recommendations for banking sector reform. These recommendations include putting in place a one-stop shop for consumer complaints, the Australian Financial Complaints Authority (AFCA); a regulated Banking Executive Accountability Regime (BEAR); and, new powers and resources for the Australian Competition and Consumer Commission (ACCC) to investigate competition issues in the setting of interest rates. The government also adopted the committee's recommendations in relation to establishing an open data regime and changing the regulatory requirement for bank start-ups in order to encourage more competition in the sector.

In October 2017, the four major banks appeared before the committee in the third round of public hearings. The banks were scrutinised on various matters, including banks not giving merchants and consumers the option to select which network processes a dual-network debit card payment. In Australia, dual-network debit cards payments can go through either the eftpos network or via MasterCard or Visa networks, known as the 'international schemes'. If a customer uses the increasingly popular 'tap-and-go' function – rather than inserting the card and selecting an eftpos or credit option – the payment will typically default to the international schemes.

The committee is concerned by the increase in transaction costs merchants face as a result of the shift to tap-and-go payments. While the eftpos and international schemes deliver the same outcome for customers, there is a marked difference in the cost to merchants. As of September 2017, the average total merchant fee for an eftpos debit transaction was 0.26 per cent, compared to 0.58 per cent with the

international schemes. It has been estimated that processing tap-and-go transactions through the international schemes costs merchants an additional \$290 million annually, which will ultimately be passed on to customers.

During the public hearings, ANZ was the only bank that committed to give merchants the option to route tap-and-go payments through the lowest cost channel. The committee acknowledges ANZ's commitment, and recommends that the other banks give merchants the ability to send tap-and-go payments from dual-network debit cards through the channel of their choice. If the banks do not do this voluntarily by 1 April 2018, the Payments System Board should take regulatory action to require this to occur. Merchants should be able to choose whether to route these transactions through eftpos or another channel, although consumers may override this merchant preference if they choose to do so.

The committee also examined the banks' decision to increase rates on existing interest-only loans, despite the Australian Prudential Regulatory Authority's (APRA) new regulatory measure only targeting the quantity of new interest-only loans. Following the rate increases, the major banks' media releases indicated that the rate increases were primarily, or exclusively, due to APRA's regulatory requirements. While it is accepted there may have been a range of factors that led to the banks increasing the interest rates of interest-only loans, there is significant concern that the public statements made by the banks may have led customers into believing that the rate increases were solely due to regulatory requirements.

Noting the ACCC's current inquiry into residential mortgage products, the committee recommends the ACCC analyse the banks' internal documents to confirm whether or not they are consistent with their public statements. It is important that this analysis is conducted at a sufficiently granular level to enable the ACCC to understand whether or not the banks' internal financial analysis was consistent with their public statements.

The major banks have failed Australians in relation to implementing comprehensive credit reporting (CCR). The CCR system gives financial institutions access to an improved set of data about customers, encouraging competition for small businesses and retail customers with positive credit histories. In addition, the CCR system allows financial institutions to better serve customers, and assess their borrowing capacity. Despite some banks making commitments to implement CCR as early as 2016, this has not yet occurred. The committee recommends that the Government introduce legislation to mandate participation in CCR as soon as practicable.

The Commonwealth Bank of Australia (CBA) is currently responding to serious allegations in the Federal Court made by the Australian Transaction Reports and Analysis Centre (AUSTRAC) in relation to CBA's alleged failure to comply with

Australia's anti-money laundering and counter-terrorism financing laws. Given the importance of the case, the major banks were scrutinised on their compliance activities in this area. To ensure that AUSTRAC continues to respond effectively to money laundering and terrorism financing in Australia, the committee recommends that the Attorney-General review the major banks' threshold transaction reporting obligations in light of the issues identified in AUSTRAC's case against the CBA.

The committee will continue to hold the banks to account in future hearings and will take further action as necessary.

David Coleman MP
Chair



Contents

Chair’s foreword iii

Membership of the Committee ix

Terms of reference x

Abbreviations..... xi

Recommendations xii

REPORT

1 Introduction 1

 Background 1

 Conduct of the inquiry 2

 Reader guide and structure of the report..... 2

2 Recommendations 3

 Dual-network debit cards and tap-and-go payments 3

 Background 3

 Discussion 5

 Conclusion 6

 Repricing of interest-only mortgages..... 8

 Background 8

 Discussion..... 11

 Conclusion 13

 Comprehensive Credit Reporting 15

 Background 15

Discussion.....	16
Conclusion	19
Anti-Money Laundering and Counter-Terrorism Financing	20
Background.....	20
Discussion.....	22
Conclusion	24
3 Key issues at public hearings.....	27
Executive accountability and the BEAR.....	27
Credit card interest rates.....	29
Small business reforms.....	30
ATM fees	33
Bank branch and employee numbers	34
Remuneration policies and incentives.....	36
Foreign exchange transactions	37
Coal industry lending practices.....	38

APPENDIX

Appendix A – Hearings and Witnesses.....	41
--	----

DISSENTING REPORT


Dissenting Report—Labor members of the committee.....	43
---	----

LIST OF TABLES

Table 2.1 June 2017 repricing of standard variable rate mortgages.....	9
--	---

LIST OF FIGURES

Figure 2.1 Housing repricing impact on net interest margins.....	10
--	----



Membership of the Committee

Chair	Mr David Coleman MP
Deputy Chair	The Hon Matt Thistlethwaite MP
Members	Mr Adam Bandt MP Ms Julia Banks MP Mr Scott Buchholz MP Mr Trevor Evans MP Mr Kevin Hogan MP Mr Craig Kelly MP Mr Matt Keogh MP Ms Madeleine King MP

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Secretary	Mr Stephen Boyd
Inquiry Secretary	Ms Samantha Mannette
Technical Advisor	Mr Jack Hargreaves
Senior Researcher	Dr John White
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Terms of reference

On 15 September 2016, the Treasurer requested that the House of Representatives Standing Committee on Economics undertake – as a permanent part of the committee’s business – an 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.

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
ADI	Authorised Deposit-taking Institution
ANZ	Australia and New Zealand Banking Group
APRA	Australian Prudential Regulation Authority
AML/TF	Anti- Money Laundering or Financing of Terrorism
ASIC	Australian Securities and Investments Commission
ATM	Automated Teller Machine
AUSTRAC	Australian Transaction Reports and Analysis Centre
BEAR	Banking Executive Accountability Regime
bps	basis points
CBA	Commonwealth Bank of Australia
CCR	Comprehensive Credit Reporting
CEO	Chief Executive Officer
FSI	Financial System Inquiry
IDM	Intelligent Deposit Machine
NAB	National Australia Bank
NPP	New Payments Platform
PSB	Payments System Board
RBA	Reserve Bank of Australia
TTR	Threshold Transaction Report



Recommendations

Recommendation 1 (paragraph 2.1)

The committee recommends that banks be required to give merchants the ability to send tap-and-go payments from dual-network debit cards through the channel of their choice.

Merchants should be able to choose whether to route these transactions through eftpos or another channel, noting that consumers may override this merchant preference if they choose to do so.

If the banks have not facilitated this recommendation by 1 April 2018, the Payments System Board should take regulatory action to require this to occur.

Recommendation 2 (paragraph 2.30)

The committee recommends that the Australian Competition and Consumer Commission, as a part of its inquiry into residential mortgage products, analyse the repricing of interest-only mortgages that occurred in June 2017.

Recommendation 3 (paragraph 2.62)

The committee recommends that the Government introduce legislation to mandate participation in Comprehensive Credit Reporting as soon as practicable.

Recommendation 4 (paragraph 2.92)

The committee recommends that the Attorney-General review the major banks' threshold transaction reporting obligations in light of the issues identified in the CEO of AUSTRAC v Commonwealth Bank of Australia case.

Introduction

Background

- 1.1 This is the House of Representatives Standing Committee on Economics' third report for the committee's review of Australia's four major banks.
- 1.2 In November 2016, the committee published its first report, which followed the first round of hearings a year ago in October 2016. The report contained 10 recommendations to reform the banking sector, including calling for new legislation and other regulatory changes to improve the operation of the banking sector for Australian consumers.
- 1.3 In a second report in April 2017, following hearings in March, the committee reaffirmed the 10 recommendations of its first report and made an additional recommendation in relation to non-monetary default clauses.
- 1.4 In the May 2017 Budget, the Treasurer announced that the Government would be broadly adopting nine of the committee's 10 recommendations for banking sector reform, including:
 - a one-stop shop for consumer complaints to be known as the Australian Financial Complaints Authority (AFCA);
 - a regulated executive accountability regime – to be known as the Banking Executive Accountability Regime (BEAR);
 - the establishment of the Financial Sector Competition Unit in the Australian Competition and Consumer Commission (ACCC) to investigate competition issues, including the setting of interest rates;
 - the establishment of an open data regime to give customers power over their own financial information; and

- a simpler regulatory regime for bank start-ups in order to encourage more competition in the sector.
- 1.5 The committee's mandate from the government to review the banking sector is ongoing, and provides an important mechanism to hold the four major banks to account before the Parliament.
- 1.6 The third round of hearings in October 2017 focused on the major banks' progress in implementing the recommendations of the committee and other matters, including those that have emerged since the last round of hearings.

Conduct of the inquiry

- 1.7 The committee held three-hour public hearings with each of the four major banks on 11 and 20 October 2017.
- 1.8 The proceedings of the hearings 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.
- 1.9 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.
- 1.10 The banks' responses to these additional requests, excluding information that was provided on a commercial-in-confidence basis, are available on the committee's website.

Reader guide and structure of the report

- 1.11 Four key issues were identified where the committee made recommendations: dual-network debit cards and tap-and-go payments; the repricing of interest-only mortgages; comprehensive credit reporting; and AUSTRAC procedures. Chapter 2 covers these recommendations.
- 1.12 Chapter 3 provides a summary of other key issues covered during the committee's public hearings.

Recommendations

Dual-network debit cards and tap-and-go payments

Recommendation 1

- 2.1 **The committee recommends that banks be required to give merchants the ability to send tap-and-go payments from dual-network debit cards through the channel of their choice.**

Merchants should be able to choose whether to route these transactions through eftpos or another channel, noting that consumers may override this merchant preference if they choose to do so.

If the banks have not facilitated this recommendation by 1 April 2018, the Payments System Board should take regulatory action to require this to occur.

Background

- 2.2 Dual-network debit cards are debit cards that allow payments to be processed through either of two networks in one physical card. In Australia, dual-network debit cards can route payment transactions through either the eftpos network, or via the networks of MasterCard or Visa – the international schemes. Dual-network debit cards can be identified as typically having logos of both schemes; often one network on the front of the card and an alternate network on the back.¹

¹ Reserve Bank of Australia (RBA), *Dual-Network Cards and Mobile Wallet Technology, Consultation Paper*: December 2016, p. 3.

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- 2.3 As of mid-2015, around 63 per cent of debit cards issued in Australia were dual-network, with the remainder being solely eftpos cards.²
- 2.4 While debit transactions processed by eftpos and the international schemes achieve the same outcome for the cardholder, the networks have substantially different costs for merchants, with the international schemes typically charging more than eftpos.
- 2.5 As of September 2017, the average total merchant fee for a debit transaction was 0.26 per cent with eftpos, and 0.58 per cent with the international schemes.³
- 2.6 With contact payments, also known as ‘dip and PIN’, the cardholder can choose which network processes their debit transaction. The cardholder does this by selecting SAV/CHQ for eftpos or CR for the international schemes.
- 2.7 However, with tap-and-go payments, also known as contactless payments, neither merchants nor cardholders are given this choice. Instead, the programming of dual-network debit cards is set such that the transaction is automatically processed through the international schemes rather than eftpos.
- 2.8 Tap-and-go technology was pioneered by the international schemes and, as a result, banks originally were only able to offer tap-and-go debit transactions through the international schemes. However, as eftpos now offers tap-and-go payments,⁴ banks have the ability to program terminals to route tap-and-go payments through the eftpos or international schemes.
- 2.9 At present, banks do not allow merchants to choose the route through which tap-and-go payments are processed.
- 2.10 It is likely that banks deny merchants this choice for commercial reasons.
- 2.11 As card issuers, the major banks receive higher interchange fees from international scheme debit transactions than from eftpos transactions. Interchange fees are fees paid by the merchant’s bank to the cardholder’s bank. These fees are set by the payment networks and are used as a way to encourage banks to issue their cards.
- 2.12 While the Reserve Bank of Australia (RBA) sets benchmarks for the average interchange fee that can be charged for debit card transactions, there is significant scope for payment networks to set fees below the benchmark.
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2 RBA, *Dual-Network Cards and Mobile Wallet Technology, Consultation Paper: December 2016*, p. 3.

3 RBA, *Average Merchant Fees for Debit, Credit and Charge Cards – C3*, <<http://rba.gov.au/statistics/tables/xls/c03hist.xls>>, viewed 14 November 2017.

4 Eftpos Australia, *eftpos Tap & Pay™*, <<https://www.eftposaustralia.com.au/products/eftpos-tap-pay/>>, viewed 14 November 2017.

- 2.13 Traditionally, eftpos has set interchange fees significantly below the benchmark while the international schemes have set interchange fees near the benchmark. As highlighted by the RBA in March 2015, this interchange fee differential has indeed made issuance of international scheme debit cards more attractive for banks:

In the debit card market, there has been a steady fall in the market share of the domestic eftpos system and a rise in the share of the MasterCard and Visa schemes. While eftpos has long been priced more favourably for merchants, interchange fee differentials have made issuance of international scheme cards more attractive for banks and other financial institutions.⁵

- 2.14 It has been estimated that processing tap-and-go transactions through the international schemes costs merchants an additional \$290 million annually.⁶
- 2.15 These additional costs significantly increase the expenses of businesses, leading to higher prices for consumers.

Discussion

- 2.16 The ANZ Chief Executive, Mr Shane Elliot, was alone amongst the witnesses in agreeing that merchants should be able to choose the lowest cost channel through which to process tap-and-go payments:

...until now there really hasn't been a choice. I think Brian [Hartzer] made the point: if you insert the card, you get to choose, but with contactless [tap-and-go], you don't, so it's defaulted to Visa. It's the machine that sits on the shop counter that makes the decision.

What we're doing now is saying: if those merchants want to default it somewhere else then we will do that for them. If that's our customer, we're happy to do that...at ANZ we've had one merchant who has come to us to ask us, 'Could you please switch the default?' We will do it. We'll work with them.⁷

- 2.17 All banks should be following the example set by ANZ to give merchants a choice in how to route tap-and-go payments made by dual-network debit cards.
- 2.18 CBA declined to give an assurance that it will give merchants the ability to route tap-and-go payments through the lowest cost option, and instead

5 RBA, *Review of Card Payments Regulation, Issues Paper: March 2015*, p. 16.

6 The Australian Retailers Association, 'ARA supportive of ANZ dual network routings', *Media release*, 19 October 2017.

7 Mr Shane Elliot, CEO, ANZ, *Transcript*, 11 October 2017, p. 44.

indicated that it would look into the matter from a consumer and technological perspective. CBA added that if routing transactions through the merchant's preferred payment network was found to be 'the best thing to do' then it would provide this service.⁸

2.19 Similarly, NAB indicated that while it would be working with merchants, it would not give an 'absolute commitment' to rerouting payments 'through different rails on the spot without knowing all the consequences of that decision.'⁹

2.20 Westpac was less willing to look at the issue, stating:

It's [routing transactions through the lower cost route, unless the cardholder expresses otherwise] more complicated than that. We don't know which card the customer wants to use and which account the customer wants to use. I think it's important to say that merchants get benefits out of the fact that Visa and MasterCard are there and provide this technology.¹⁰

2.21 When it was raised that customers do not have the ability to choose which network processes their tap-and-go debit transaction, some of the banks argued that customers choose by selecting a particular card. Westpac commented that 'today the customer chooses, depending on which card they pull out of their wallet.'¹¹ The committee disagrees with this assertion.

2.22 As tap-and-go payments are effortless and expedient, the cardholder is making this decision out of convenience, not as an active decision to route their payment through the international scheme.

2.23 While card schemes can compete on non-price value, eftpos has provided similar chargeback rights to the international schemes since November 2015. Generally, loyalty rewards are not offered by the international schemes for transactions on debit cards.

Conclusion

2.24 The committee is concerned by the increase in transaction costs merchants now face as a result of the shift to tap-and-go payments. These costs are ultimately borne by customers.

8 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 77.

9 Mr Andrew Thorburn, CEO, NAB *Transcript*, 20 October 2017, p. 10.

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

11 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 27.

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- 2.25 The committee rejects the implausible contention of Westpac Chief Executive Mr Brian Hartzler that, by using a dual network card, the consumer has chosen to use the international scheme, rather than eftpos.
- 2.26 The committee acknowledges ANZ's commitment to offer least-cost routing to merchants, and recommends that the other banks give merchants the ability to send tap-and-go payments from dual-network debit cards through the lowest cost channel.
- 2.27 If the banks have not implemented these recommendations by 1 April 2018 the Payment System Board should introduce standards requiring banks to allow merchants to choose which channel through which to route a tap-and-go payment.
- 2.28 Consumers should retain the right to override the merchant's choice of channel.
- 2.29 Consumers should be made aware of the manner in which each tap-and-go payment is processed. If the default method is eftpos, the consumer can override that default by selecting the international scheme at the point of sale.

Repricing of interest-only mortgages

Recommendation 2

2.30 **The committee recommends that the Australian Competition and Consumer Commission, as a part of its inquiry into residential mortgage products, analyse the repricing of interest-only mortgages that occurred in June 2017.**

Background

2.31 On 31 March 2017, the Australian Prudential Regulation Authority (APRA) announced a 30 per cent limit on the share of new mortgages which could have interest-only repayment. This means that of 100 new mortgages, a maximum of 30 could have an interest-only repayment schedule. This built on measures announced by APRA in December 2014.

2.32 Interest-only mortgages are typically considered to be more risky than principle-and-interest mortgages because:

- customers are not required to make principle repayments during the interest-only period; and
- repayments increase at the end of the interest-only period when consumers start paying principle as well as interest.

2.33 Given risks stemming from high house prices, rising household indebtedness and low interest rates, APRA considered it prudent for banks to shift away from interest-only mortgages and towards principle-and-interest mortgages.

2.34 At the time of announcement, mortgages with interest-only terms represented around 40 per cent of mortgage lending.¹²

2.35 Following the March 2017 announcement by APRA, the major banks announced rates increases on interest-only mortgages of 30 basis points (bps) or more. At the same time, they either left rates unchanged or decreased rates on principle-and-interest mortgages (Table 2.1).¹³

12 APRA, 'APRA announces further measures to reinforce sound residential mortgage lending practices', *Media release*, 31 March 2017.

13 Several mid-tier banks also increased rates on interest-only loans over this period.

Table 2.1 June 2017 repricing of standard variable rate mortgages

	Owner-occupier interest-only	Investor interest-only	Owner-occupier Principal and interest	Investor Principal and interest
ANZ	+30 bps	+30 bps	-5 bps	-5 bps
CBA	+30 bps	+30 bps	-3 bps	no change
NAB	+35 bps	+35 bps	-8 bps	no change
WBC	+34 bps	+34 bps	-8 bps	no change

Source: Bank media releases¹⁴

2.36 The major banks' media releases that accompanied the price changes stated that the changes were required to meet the new regulatory requirement, including:

- CBA's media release on 27 June 2017 that stated: 'To meet our regulatory requirements, variable interest only home loan rates for owner-occupiers and investors will increase by 30 basis points.'¹⁵
- Westpac's media release on 20 June 2017, which stated:
APRA's limit on new interest only lending is 30% of new residential mortgage lending, so we have to continue to make changes to our interest only rates and lending policies to meet this benchmark.¹⁶

2.37 While the media releases indicate that the rate increases were primarily, or exclusively, due to APRA's regulatory requirements, the banks stated under scrutiny that other factors contributed to the decision. In particular, banks acknowledged that the increased interest rates would improve their profitability.

2.38 A key reason for such an improvement is that the major banks increased rates on both new and existing interest-only loans in June 2017. This is despite APRA's interest-only measure only targeting new lending.

2.39 As of 6 October 2017, analysts at CLSA estimated that the banks' net interest margins increased by up to 12 bps (Figure 2.1) following the rate increases announced in June and March.¹⁷

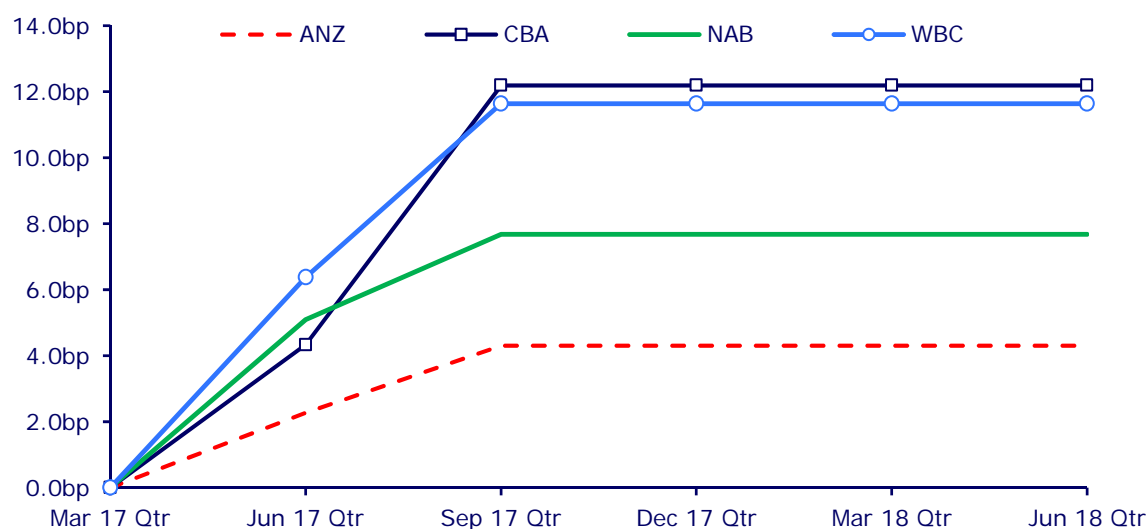
14 ANZ, 'Update on ANZ interest rates', *Media release*, 9 June 2017; CBA, 'CBA changes home loan interest rates', *Media release*, 27 June 2017; NAB, 'NAB announces changes to variable home loan rates', *Media release*, 23 June 2017; and Westpac, 'Westpac adjust home loan interest rates', *Media release*, 20 June 2017.

15 CBA 'Commonwealth Bank changes home loan interest rates', *Media release*, 27 June 2017.

16 Westpac, 'Westpac adjusts home loan interest rates', *Media release*, 20 June 2017.

17 CLSA, Australian Banks Sector Outlook, *Housing Repricing Impacts*, 6 October 2017, p 5.

Figure 2.1 Housing repricing impact on net interest margins



Source: CLSA

2.40 The improvement in net interest margins is forecast to be so beneficial for Westpac that several analysts upgraded their outlook following the price announcements in June 2017:

- Upgrade to outperform ... So far WBC appears to be the key beneficiary of the industry's successful mortgage repricing (WBC putting through larger mortgage rate increases in relation to a relatively large portion of their portfolio).¹⁸
- Upgrade to overweight ... In our view, WBC is a bigger beneficiary than its major bank peers of the accelerating trend towards differentiated repricing.¹⁹

2.41 While the reaction does not appear to have been as strong for other banks, analysts still suggest the changes will improve profitability. Macquarie suggested that 'the timing of recent mortgage repricing provides a material tailwind to CBA in FY18' and estimated approximately \$500 million revenue uplift.²⁰ Morgan Stanley forecast that:

In the near term, re-pricing supports [NAB] group margins, which we forecast to expand to 1.85% in 2H17 and 1.89% in 1H18 from 1.82% in 1H17.²¹

18 Credit Suisse, *Westpac: "Winners and Losers" pricing is a winner*, Analyst report, 22 June 2017, p. 1.

19 Morgan Stanley, *Westpac: Upgrade to Overweight*, Analyst report, 19 July 2017, p. 1.

20 Macquarie, *Commonwealth Bank: Down But Not Out*, Analyst report, 12 September 2017, p. 1.

21 Morgan Stanley, *National Australia Bank: Beyond the Turnaround*, Analyst report, 10 September 2017, p. 1.

- 2.42 While banks are commercial entities that will seek to drive financial results, it is critical that their public statements about interest rate movements are accurate and not misleading or deceptive.

Discussion

- 2.43 During the hearings, the banks claimed that APRA's regulatory requirement was a key reason for the changes in interest rates announced in June 2017. CBA stated:

...we made the change in order to meet our regulatory requirements is a correct statement – that was the motivation and absent that change in regulatory requirements the change in pricing would not have been made.²²

- 2.44 However, the banks indicated that the changes were also aimed at moving existing customers towards paying principal and interest. Westpac outlined its dual objectives as:

...one was to meet the APRA requirement, and the other was to reshape the mortgage portfolio to have less interest-only, which required some back book switching.²³

- 2.45 Similarly, NAB stated its 'focus was absolutely on meeting the 30 per cent of flow' APRA requirements. However, it also 'took the opportunity to reposition the back book to encourage our customers to switch from interest-only to P&I.'²⁴

- 2.46 The banks suggested that it was prudent to encourage existing customers to repay principal in addition to reducing the flow of new interest-only customers. Indeed, some highlighted that they had made some adjustments to orientate customers towards paying principal before APRA's requirement was announced on 31 March. For example, ANZ stated:

We started changing our approach in terms of lending standards, policies and pricing well before APRA put in place that speed limit. In fact, our first changes around interest-only loans started in April 2016.²⁵

- 2.47 Noting the Australian Competition and Consumer Commission's (ACCC) mortgage price inquiry, the banks were asked whether the ACCC would

22 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 48.

23 Mr Peter King, CFO, Westpac, *Transcript*, 11 October 2017, p. 9.

24 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 7.

25 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 42.

find that the public statements were entirely consistent with their internal analysis. The banks stated they will. Westpac stated:

The statements are accurate and they will be seen to be accurate, but they do reflect judgement. It's not a mathematical formula; it was a judgement that we made.²⁶

2.48 Westpac claimed that while it considers 'commercial issues', it stressed that the 'primary driver' for its rate increases was to 'meet the APRA requirements while preserving choice for customers.'²⁷

2.49 Similarly, NAB argued that the focus of increasing its interest rates was on meeting the APRA requirements. NAB stated:

We undertook a lot of scenario modelling to understand how this may play out financially, but our core focus was in response to the requirement from the regulator.²⁸

2.50 Further, the banks suggested that the ultimate impact on profitability was difficult to forecast because it was hard to predict switching. Westpac stated:

...we made a forecast, but the truth is that whereas often our forecasting is pretty accurate, in this case, we found and continue to find it very hard to know what the net effect is going to be, because we don't know what the switching is going to be.²⁹

2.51 Within this context, the banks were asked whether they had modelled the financial consequences of the decision. The banks indicated that they had undertaken extensive financial analysis, with the primary focus being the likely response from customers under a range of price differentials. For example, NAB stated:

...we undertook modelling to try to understand where our competitors may move and what we would need to do to ensure that we met the 30 per cent.³⁰

2.52 The banks noted that they also examined the financial impact of a range of scenarios. Westpac stated:

We made estimates as to how big of a differential we would need to change in the different rates in order to achieve the regulatory outcome that we were striving to achieve, which was the primary

26 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

27 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 6.

28 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 6.

29 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

30 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 7.

driver. Then, yes, of course, we update our forecasts, financially, as a result of those changes – not the other way around.³¹

2.53 After repeated scrutiny during the public hearings, NAB acknowledged that under its best estimate, the price changes would likely lead to an uplift in revenue, stating:

...we've done some assumptions; we've done our best prediction; the next day it'll change; but the best estimate would've been positive.³²

2.54 While it is accepted there may have been a range of factors that led to the banks increasing the interest rates of interest-only loans, there is significant concern that the public statements made by the banks may have led customers into believing that the interest rate increases were solely due to regulatory requirements.

Conclusion

2.55 The ACCC is currently conducting an inquiry into residential mortgage products. This inquiry was established to monitor price decisions following the introduction of the Major Bank Levy.

2.56 As a part of this inquiry, the ACCC can compel the banks affected by the Major Bank Levy to explain any changes to interest rates in relation to residential mortgage products. The inquiry relates to prices charged until 30 June 2018.

2.57 The committee recommends that the ACCC analyse the banks' internal documents to assess whether or not they are consistent with their statements in their June 2017 media releases and subsequent public commentary.

2.58 In particular, the ACCC should analyse the banks' decisions to increase interest rates on existing borrowers despite APRA's measure only targeting new borrowers.

2.59 Further, the ACCC should consider whether the banks' public statements adequately distinguish between new and existing borrowers. The ACCC should consider whether the media statements suggest rates on existing interest-only mortgages rose as a direct consequence of APRA's regulatory requirement.

2.60 It will be important that the ACCC conducts granular analysis of the financial modelling of the banks. The ACCC will need to understand the

31 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 9.

32 Mr Andrew Thorburn, CEO, NAB *Transcript*, 20 October 2017, p. 23.

true financial impact on the banks of APRA's regulatory changes, and assess that impact against the public statements of the banks.

- 2.61 The committee welcomes recent confirmation from the ACCC that it will analyse the June 2017 announcements,³³ and looks forward to the outcomes of the ACCC's investigation on this matter.

33 Article: Richard Gluyas, 'Hints for ACCC as David Coleman Follows the Money', *The Australian*, 12 October 2017.

Comprehensive Credit Reporting

Recommendation 3

- 2.62 **The committee recommends that the Government introduce legislation to mandate participation in Comprehensive Credit Reporting as soon as practicable.**

Background

- 2.63 In March 2014, the *Privacy Act 1988* was amended to enable a more complete view of a person's credit history to be included in a credit report, known as Comprehensive Credit Reporting (CCR).³⁴
- 2.64 Before CCR, a person's credit report only provided limited information about the credit history. This mostly included negative information about that credit history, such as overdue debts, bankruptcy or court judgements.
- 2.65 CCR also allows for the positive characteristics of a consumer's credit history to be reported in full. For instance, a customer who has always paid their credit card account and mortgage on time will have this reflected in their CCR report. This positive history will be beneficial for that customer when financial services providers assess the terms on which to offer them financial service products.
- 2.66 With the introduction of CCR, credit reports can include more information about the credit products a person has, and how they have managed their credit. This includes information about the number of accounts a customer has opened, credit limits on those accounts, and details of monthly payments.
- 2.67 The CCR system gives financial institutions access to a deeper, richer set of data, encouraging competition for small businesses and retail customers with positive credit histories. In addition, the CCR system allows financial institutions to better serve customers, and assess their borrowing capacity.
- 2.68 As noted by the Financial System Inquiry (FSI), the net benefit of CCR increases as the regime covers more customers. However, the major banks have little incentive to participate because the cost of sharing their data

34 Office of the Australian Information Commissioner, *Credit Reporting*, <<https://www.oaic.gov.au/privacy-law/privacy-act/credit-reporting>>, viewed 14 November 2017.

with competitors is likely to be greater than the benefit of gaining access to their competitors' data. As the owners of most of the key data, the banks have limited commercial incentive to share this information with smaller financial services companies.

- 2.69 Due to this situation, in December 2014 the FSI recommended the Government mandate participation in the CCR regime if voluntary uptake remained inadequate.
- 2.70 Following the FSI's recommendation, in May 2017, the Productivity Commission recommended that the Government adopt a minimum target for voluntary participation in CCR of 40 per cent.
- 2.71 The Productivity Commission recommended that if the target was not met by 30 June 2017, the Government should circulate draft legislation by 31 December 2017 to impose mandatory participation in CCR.
- 2.72 In response, on 9 May 2017, the Government announced it would legislate for a mandatory CCR regime if credit providers were not reporting at least 40 per cent of their data by the end of 2017.
- 2.73 Despite this, as at June 2017 the volume of CCR data being reported in public mode, meaning it is accessible by other credit providers, remains small.³⁵
- 2.74 On 9 October 2017, NAB announced it will implement CCR and publicly report data from February 2018.³⁶ NAB intends to phase in its implementation of different credit products, commencing with personal loans, credit cards and overdrafts. On 9 October 2017, CBA also committed to participate in 2018.³⁷
- 2.75 On 2 November 2017, the Treasurer announced that the Government will legislate for a mandatory CCR regime to come into effect by 1 July 2018.³⁸

Discussion

- 2.76 During public hearings, the banks committed to participating in the CCR in 2018:
- [Westpac] it is our intent to join that regime and for it to probably be live mid next year³⁹

35 Australian Retail Credit Association, *ARCA Credit Data Fact Base, Volume 2*, June 2017.

36 NAB, 'NAB announces start to Comprehensive Credit Reporting', *Media release*, 9 October 2017.

37 CBA, 'CBA confirms support for Comprehensive Credit Reporting (CCR)', *Media release*, 9 October 2017.

38 The Treasurer, The Hon. Scott Morrison MP, 'Mandating comprehensive credit reporting', *Media Release*, 2 November 2017.

39 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 35.

- [ANZ] we will start sharing comprehensive credit data next year⁴⁰
 - [NAB] we go live in February⁴¹
 - [CBA] we'll be participating fully in the comprehensive credit reporting regime in 2018.⁴²
- 2.77 The banks were questioned on whether they would follow through on this, noting that they have previously made similar statements, and the timelines for delivery had often been revised. For example, in response to the FSI's Interim Report, on 29 August 2014 ANZ stated:
- Comprehensive credit reporting (CCR) is a major improvement to the availability of information and will provide significant benefits to financial institutions, consumers, and small businesses over time. ANZ is implementing CCR systems and would expect the market will inevitably move towards the inclusion of SME lending in CCR.⁴³
- 2.78 Then in response to the FSI's Final Report, on 31 March 2015 ANZ stated:
- ANZ is making major investments in the CCR capabilities and anticipates it will be able to 'use' or 'provide' CCR data by 2016-17.⁴⁴
- 2.79 Again, in response to the Productivity Commission's Issues Paper on Data Availability and Use, on 29 July 2016 ANZ stated:
- As noted in our submission to the Financial System Inquiry, ANZ supports CCR and is making a significant investment in its reporting capabilities. We expect to be providing and receiving CCR data in 2017-18.⁴⁵
- 2.80 Finally, in response to the Productivity Commission's Draft Report on Data Availability and Use, on 12 December 2016 ANZ stated:
- We have few concerns with the Commission's recommendation [to mandate participation if voluntary uptake remains below 40 per cent] on comprehensive credit reporting.⁴⁶

40 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 39.

41 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 24.

42 Mr Ian Narev, CEO, ANZ, *Transcript*, 20 October 2017, p. 40.

43 ANZ, *Response to the Interim Report of the Financial System Inquiry*, 26 August 2014, p. 15.

44 ANZ, *Response to the Final Report of the Financial System Inquiry*, 31 March 2015, p. 11.

45 ANZ, *Submission to the Productivity Commission: Issues Paper: Data Availability and Use*, 29 July 2016, p. 8.

46 ANZ, *Submission to the Productivity Commission: Data Availability and Use Draft Report*, 12 December 2016, p. [7].

2.81 In response to this line of questioning, the banks argued that the project was complex. They further argued that they wanted to ensure that their customers' data would be secure before proceeding. The banks stated:

- We've been in private mode for the last two years, sharing data with all three of the credit bodies. We've actually been in testing to understand: does all the information flow move correctly? There are still a number of questions outstanding at this point in time.⁴⁷
- The real issues and limiting factors are that there is a lot of process to change and there is a technology investment required.⁴⁸
- The second point has been more of a policy point, which is about protection of customers' data and protection from fraud...The reality of the digital world that we live in and the very real fraud risks and cyber-risks that are out there mean that we need to be careful about this, and it can go very wrong very quickly.⁴⁹

2.82 When scrutinised about the significant lapse of time, Westpac admitted that other projects had been prioritised over CCR and that this had resulted in its delivery being delayed:

The reality is we've had an enormous number of requests to us for data and improvements in technology and systems that, quite frankly, have been prioritised higher than this.⁵⁰

2.83 The banks rejected the committee's assertion that they had not participated because it was not beneficial from a commercial point of view. However, some banks admitted that the benefit is likely to be small. Westpac's CEO stated that 'my personal opinion is there will be a slight net positive for us'.⁵¹

2.84 Even with these clear delays, the NAB continued to argue against regulation:

Well, our view is that it shouldn't be regulated. We have already now stated we are moving in, so we've done it without regulation coming in.⁵²

47 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 37.

48 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 42.

49 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, pp. 35-36.

50 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 35.

51 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 36.

52 Mr Antony Cahill, COO, NAB, *Transcript*, 20 October 2017, p. 37.

Conclusion

- 2.85 Despite many commitments by banks in the past to implement CCR, little progress has been made.
- 2.86 As highlighted at the public hearings, other projects have often been prioritised over CCR, delaying its implementation. As a result, CCR should be mandated to ensure the major banks start reporting in 2018.
- 2.87 While banks have been able to participate in CCR since March 2014, it was disappointing to learn that not a single major bank will participate in CCR before December 2017. NAB is the most advanced of the banks, and it will only begin reporting in February 2018.
- 2.88 In this year's Budget, the Government committed to mandating a comprehensive credit reporting regime if providers did not meet a threshold of 40 per cent data reporting by the end of 2017.⁵³
- 2.89 Given the major banks represent around 75 per cent of the household credit market, the 40 per cent target set by Government will not be met. As a result, there is no benefit in waiting until December to mandate the regime.
- 2.90 On 2 November 2017, the Government announced it will introduce legislation to Parliament to mandate the CCR regime. It is important that this occur quickly given the years that have elapsed with limited action in this area.
- 2.91 In mandating participation, the Government should ensure it does not penalise credit providers that have moved ahead of the industry and are on track to report positive data in public mode shortly.

53 The Treasurer, The Hon Scott Morrison MP, 'Mandating comprehensive credit reporting', *Media Release*, 2 November 2017.

Anti-Money Laundering and Counter-Terrorism Financing

Recommendation 4

2.92 **The committee recommends that the Attorney-General review the major banks' threshold transaction reporting obligations in light of the issues identified in the CEO of AUSTRAC v Commonwealth Bank of Australia case.**

Background

2.93 The CBA is currently responding to serious allegations in the Federal Court. AUSTRAC alleges CBA contravened section 43 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (the Act) on more than 50,000 occasions. The allegations arise from CBA's introduction of Intelligent Deposit Machines (IDMs) in May 2012.

2.94 IDMs are a type of ATM that accept deposits in cash and cheque, and can automatically credit the nominated recipient account. The funds are then available for immediate transfer to other accounts both domestically and internationally. The CBA's IDMs can accept up to 200 notes per deposit, or up to \$20,000 per cash transaction. The CBA does not limit the number of IDM transactions a customer can make per day.⁵⁴

2.95 Under the Act, banks are required to report suspicious activity, primarily through threshold transaction reports (TTRs) for deposits made through an IDM. Banks are also required to take certain steps to manage their Anti-Money Laundering or Financing of Terrorism (AML/TF) risk.⁵⁵

2.96 AUSTRAC claims that, as a result of CBA's failure to comply with the Act, 'AUSTRAC and other law enforcement and designated agencies have been deprived of information which the Act is intended to provide', and 'the effect of CommBank's conduct in this matter has exposed the Australian community to serious and ongoing financial crime.'⁵⁶

2.97 On 4 September 2017, the first case management hearing was held in relation to AUSTRAC's allegations against CBA. The court ordered CBA

54 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

55 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

56 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

- to file its defence by 15 December 2017, with a further case management hearing to occur on 2 April 2018.⁵⁷
- 2.98 The committee will closely monitor the progress of this matter, and will fully scrutinise the CBA when the case is finalised.
- 2.99 In addition to AUSTRAC's case against CBA, APRA announced on 28 August 2017 that it would establish 'an independent prudential inquiry into the Commonwealth Bank of Australia (CBA) focusing on governance, culture and accountability frameworks and practices within the group.'⁵⁸
- 2.100 APRA advised that it will identify any core organisational and cultural drivers that have contributed to the recent incidents with CBA, and assess whether CBA's structure, culture, remuneration, or accountability frameworks are conflicting with sound risk management and compliance outcomes. A progress report for the inquiry will be submitted to APRA by 31 January 2018, with the final report to be submitted by 30 April 2018.⁵⁹
- 2.101 Further, on 9 October 2017, a class action was filed by Maurice Blackburn on behalf of investors who suffered losses due to the share price fall following the institution of legal proceedings by AUSTRAC against CBA. The class action claims:⁶⁰

When news of the AUSTRAC proceeding became public, CBA's share price fell from an intra-day high of \$84.69 on 3 August 2017 to an opening price of \$80.11 on 7 August 2017 (a fall of \$4.58 or 5.4%) – a significant movement for an otherwise stable stock.

The class action alleges that CBA knew about serious instances of non-compliance with the AML/CTF Act and that its failure to disclose that information to the ASX amounts to misleading and deceptive conduct and a breach of its continuous disclosure obligations under the *Corporations Act 2001* (Cth) and the ASX Listing Rules.⁶¹

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- 57 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Directions Orders*, NSD1305/2017, 4 September 2017.
- 58 APRA, 'APRA to establish independent prudential inquiry into governance, culture and accountability within CBA', *Media Release*, 28 August 2017.
- 59 APRA, 'APRA announces panel members and terms of reference for prudential inquiry into CBA', *Media Release*, 8 September 2017.
- 60 Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd, Federal Court of Australia – Victoria Registry, *Statement of Claim*, VID1085/2017, 9 October 2017.
- 61 Maurice Blackburn, *Commonwealth Bank of Australia class action*, <<https://www.mauriceblackburn.com.au/current-class-actions/commonwealth-bank-of-australia-class-action/>>, viewed 17 November 2017.

- 2.102 On 6 November 2017, orders were made by consent that CBA would file its defence for the shareholder class action by 23 February 2018, with a further case management hearing to occur on 16 March 2018.⁶²
- 2.103 The committee will closely monitor the progress of the shareholder class action, and the outcome of APRA's prudential inquiry into the CBA.

Discussion

- 2.104 The CBA was asked why the board did not disclose the alleged breaches before AUSTRAC initiated legal proceedings, given it was aware in 2015 that the bank failed to submit more than 50,000 TTRs. The CBA claimed that the board had met its continuous disclosure obligations based on its knowledge at the time.
- 2.105 Given CBA was aware in 2015 that the failure to lodge over 50,000 TTRs exposed them to a very large fine, it is surprising that CBA did not, at the very least, disclose the coding error which it has since rectified.
- 2.106 In addition, there is serious concern that the board did not identify any issues related to executive management conduct in 2015 that would result in the loss or minimisation of executive bonuses. Despite being aware of the failure to lodge 50,000 TTRs, the board's 2015-16 remuneration report did not identify any concerns that the bank was potentially exposed to billions of dollars in fines. In response to questioning on this issue, CBA stated:
- ...the determination [in relation to the remuneration report 2015-16] was made according to the processes that we apply in our remuneration framework and the elements that go into that, in terms of the risk review, and it included the regulatory matters at the time. We're confident that we've met our disclosure obligations and that, as I've said, the view that we formed around AUSTRAC and the failed TTRs, given our knowledge at that time, was the appropriate outcome.⁶³
- 2.107 When further scrutinised on the decision to award senior executives their executive bonuses in 2015, despite being aware of CBA's failure to lodge 50,000 TTRs, CBA maintained that it had made the correct decision on the basis of the facts as the board knew at the time.⁶⁴
- 2.108 The Australian Securities and Investments Commission (ASIC) Chairman has confirmed that ASIC is looking into the actions of CBA's board and

62 *Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd*, Federal Court of Australia – Victoria Registry, *Directions Orders*, VID1085/2017, 1 November 2017.

63 Ms Catherine Livingstone, Chairman, CBA, *Transcript*, 20 October 2017, p. 42.

64 Ms Catherine Livingstone, Chairman, CBA, *Transcript*, 20 October 2017, p. 43.

determining whether to pursue any formal action against the board collectively, or individuals within the board. The committee will monitor the outcomes of ASIC's deliberations in relation to this matter.

- 2.109 The CBA was questioned on allegations that criminals used a technique called 'structuring', where they made several deposits under the \$10,000 threshold to avoid triggering a TTR. In particular, the AUSTRAC statement of claim suggests CBA identified a suspicious pattern of activity on a number of occasions. However, CBA failed to provide AUSTRAC with appropriate reports in relation to the suspicious activity. CBA maintained it could not elaborate due to the AUSTRAC legal proceedings.
- 2.110 The banks were also asked how they determined cash limits on IDMs, noting that CBA had established a significantly higher limit than the others. The banks claim that the limits were an attempt to balance customer convenience with the risk of money laundering.
- 2.111 When it was suggested that setting a higher limit had a commercial benefit, such as increasing new business, the banks claimed this was not a primary motivation.
- 2.112 Confirmation was sought that the banks' machines were compliant with AML/TF laws. The banks unanimously claimed they were. NAB, Westpac and ANZ outlined their positions as follows:
- [NAB] With regard to intelligent deposit machines, IDMs our maximum cash deposit limit is \$5,000, and AUSTRAC has advised us they have no issues with our IDM approach.⁶⁵
 - [Westpac] We are confident that we're complying with regulations. We work very closely with AUSTRAC, and I think it's important to mention in the context of this that just having a limit of how much you take is not the start and end of your controls. We have very extensive computer analysis that goes on that looks at patterns and transactions, and for people trying to avoid the reporting by, for example, breaking up their deposit and structuring it into multiple packets.⁶⁶
 - [ANZ] AUSTRAC has advised us that it has found no evidence of noncompliance concerning our ATM network.⁶⁷
- 2.113 However, in its 2017 Annual Financial Report, NAB identified issues in relation to its AML/CTF compliance:
- The Group is currently investigating and remediating a number of identified issues, including certain weaknesses with the implementation of 'Know Your Customer' requirements and

65 Mr Andrew Thorburn, CEO, NAB, *Transcript*, 20 October 2017, p. 2.

66 Mr Brian Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 3.

67 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 39.

systems and process issues that impacted transaction monitoring and reporting for some specific areas.

It is possible that, as the work progresses, further issues may be identified and additional strengthening may be required. The outcomes of the investigation and remediation process for specific issues identified to date, and for any issues identified in the future, are uncertain.⁶⁸

- 2.114 Finally, CBA was questioned about why it had chosen a fundamentally different limit on its machines to the others. CBA noted that the critical difference with its approach was that it allowed more notes to be accepted, claiming it wanted to help small businesses who need to deposit large numbers of low value notes.⁶⁹ CBA further claimed that setting a higher limit did not fundamentally increase the risk of money laundering because the IDMs would still generate appropriate reports to AUSTRAC.
- 2.115 In the initial period from June 2012 to November 2012, a total of \$89.1 million was deposited in CBA's machines. However, from January 2015 to June 2015, \$3.35 billion was deposited. Given the exponential increase, CBA was asked whether it had undertaken another money laundering risk assessment. CBA claimed that due to the legal proceedings with AUSTRAC, it could not comment.

Conclusion

- 2.116 The claims made by AUSTRAC in relation to CBA's failure to comply with the Act are very serious.
- 2.117 Under the Act, banks are required to report suspicious activity, primarily through TTRs for deposits made through an IDM. Banks are also required to take certain steps to manage their AML/TF risk.⁷⁰
- 2.118 However, money laundering and terrorism financing methods, by their very nature, continue to evolve and criminals will always look for new ways to exploit opportunities and avoid detection.
- 2.119 Technological advances, market developments, and the emergence of new products and services can create new and evolving risks that may fall outside the scope of the current TTR reporting obligations.
- 2.120 The committee recognises the work AUSTRAC has done in identifying failures under the Act, and in managing AML/TF risk.

68 NAB, *2017 Annual Financial Report*, 14 November 2017, p. 108.

69 Mr Ian Narev, CEO, CBA, *Transcript*, 20 October 2017, p. 51.

70 Chief Executive Officer of the Australian Transaction Reports and Analysis Centre V Commonwealth Bank of Australia Ltd, Federal Court of Australia – New South Wales Registry, *Concise Statement*, NSD1305/2017, 3 August 2017.

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- 2.121 The committee notes the Government is consulting with industry on proposals to implement the recommendations from the report of the statutory review of the AML/CTF regime (April 2016). The report, which was released prior to AUSTRAC's allegations against the CBA, contains 84 recommendations to streamline and strengthen Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime.
- 2.122 To ensure that AUSTRAC continues to respond effectively to money laundering and terrorism financing in Australia, the committee recommends that the Attorney-General review the major banks' TTR obligations in light of the issues identified in AUSTRAC's case against the CBA.

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.

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
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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 Hartzler, 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 Hartzler, 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 Hartzler, 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 Hartzler, 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 Hartzler, 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 Hartzler, CEO, Westpac, *Transcript*, 11 October 2017, p. 17.

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

36 Mr Brian Hartzler, 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 Hartzler, 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 Hartzler, 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 tCO₂/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.

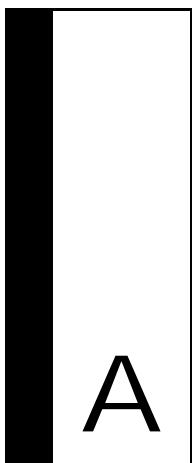
50 Mr Shane Elliott, CEO, ANZ, *Transcript*, 11 October 2017, p. 65.

51 Mr Brian Hartzler, 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



Appendix A – Hearings and Witnesses

Wednesday, 11 October 2017—Canberra

Westpac

Mr Brian Hartzler, CEO

Mr Peter King, Chief Financial Officer

Australia and New Zealand Banking Group

Mr Shayne Elliott, CEO

Mr Graham Hodges, Deputy CEO

Ms Alexis George, Group Executive, Wealth Australia

Friday, 20 October 2017—Canberra

National Australia Bank

Mr Andrew Thorburn, CEO

Mr Antony Cahill, Chief Operating Officer

Commonwealth Bank of Australia

Mr Ian Narev, CEO

Ms Catherine Livingstone AO, Chairman

Dissenting Report—Labor members of the committee

Introduction

The third hearing of the Bank CEOs once again proved the farcical nature of these hearings that allow only 10 to 20 minutes each to question the most powerful executives in the country. Each time the CEOs appear before the Committee it reinforces the need for a Royal Commission into banking in Australia.

This is exactly what has happened.

Since the beginning of this process over a year ago it has been clear that the House of Representatives Liberal Government dominated Economics committee was being used as a vehicle for the Turnbull Government to avoid the scrutiny of a Royal Commission. Again and again the Labor members pointed out the futility of this exercise and have questioned how the banks were preparing for a Royal Commission. Labor members of this committee have been vindicated as the Turnbull Government has now agreed to conduct a Royal Commission at the request of the Banks themselves. The letter from the banks to the Prime Minister clearly indicates that the banks themselves knew a Royal Commission was inevitable and have been preparing for one for some time.

The poor behaviour of the Big Four Banks

Commonwealth Bank of Australia - Austrac scandal

One of the biggest scandals in Australia's corporate history is currently playing out in our courtrooms.

The Commonwealth Bank of Australia is currently being prosecuted in the Federal Court by Austrac claiming it breached the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Act.

These money laundering allegations relate to combined cash deposits of over \$624.7 million. Austrac say that the use of CBA's intelligent deposit machines (IDMs) allowed criminals to wash money through the Australian banking system.

CBA's IDMs allowed lots of up to 200 individual notes (around \$20,000 at a time) to be deposited. Transactions of \$10,000 or more must be reported and CBA did not report these transactions on 53,506 occasions between November 2012 and September 2015.

This failure has exposed the Commonwealth Bank, its shareholders and the Australian community to enormous risk.

Worse still is the fear that the CBA will attempt to settle this matter out of court and out of the eye of the public.

Mr THISTLETHWAITE: The concern that I have is that the Commonwealth Bank will settle this matter. There's been one other prosecution under this legislation with Tabcorp. That was settled for a multimillion dollar settlement. It's my view that this will probably settle. I don't have any inside knowledge or anything on that, but this will probably settle, and no-one will actually know what went on here. The Commonwealth Bank will pay some money. You'll pay some money in respect to the shareholder class action. No-one is the wiser about what occurred here. Everything just moves on. The bank says, 'There's nothing to see.'

This cannot and must not be the outcome in this matter.

Two major law firms have launched action in the Federal Court alleging the CBA Board knew about these breaches for over two years and failed to inform investors. The statement of claim filed by the applicants in the class action alleges CBA management knew of the issues with a failure to report above threshold transactions through IDMs with Austrac. Instead of attempting to assure the Australian people that the bank was doing all it can to change its ways, it used the upcoming court proceedings to hide the extent of its deception.

Mr THISTLETHWAITE: Okay. I just want to move on to the issue of the regulator and the market... When were you first informed?

Mr Narev: We were first informed of it at senior executive board level at the time in 2015, having received information – and I think I'm right – actually from the bank about suspicious activity.

Mr THISTLETHWAITE: Who informed you?

Mr Narev: I would need to check on this, but I think this came up through the risk management team.

Mr THISTLETHWAITE: Okay. And how was the board informed, Ms Livingstone? Was it by Mr Narev? Or was it –

Ms Livingstone: That would be through the regular reporting to the risk committee and to the board in terms of the regulatory report. That includes all regulatory breaches.

Mr THISTLETHWAITE: I just want to move to the statement of claim that's been filed by some shareholders. In paragraph 41 of that statement of claim they allege that Mr Toevs, who was the chief risk officer at that time, should reasonably have become aware in the course of carrying out his duties that this was an issue. What's the bank's response to that?

Mr Narev: We've said we're going to defend the claim. Given that that's a specific allegation in the statement of claim, we won't comment on it specifically except to say that the expectation that the board has of me and that the board and I in turn have of all the executives is that they escalate issues that they've identified that should be problematic and make due inquiry.

The Commonwealth Bank clearly know about the size and scope of this matter for over two years and chose not to alert the market, the banks stakeholders or the wider community.

Bank Scandals Continue

A non-exhaustive list of the headline scandals involving the banks makes for very poor reading. Below is a selection of bad news stories for each of the banks since the last time this committee reported.

Even though the Government has finally bowed to pressure to hold a Royal Commission, not one of these scandals was considered significant enough to justify the enquiry. Instead the Prime Minister blamed Labor for its establishment. This list shows just how out of touch the PM is when it comes to this issue.

The Commonwealth Bank

2 February 2017 – Bankwest, a division of CBA has refunded \$4.9m to 10,800 customers after it failed to take into account customers' offset accounts when calculating interest on home loans.¹

8 February 2017 – CBA will pay \$23m in compensation to customers who received bad advice from staff at the centre of the bank's financial planning scandal. Over 8,600 customers received advice from financial planners between September 2003 and July 2012.²

21 February 2017 – CBA is investigating allegations that it underpaid compulsory superannuation payments to part-time workers working above initially agreed hours. Over 7000 part-time staff are owed millions of dollars in unpaid superannuation entitlements, according to legal advice.³ Ultimately CBA accepted that it had underpaid the employees.

28 April 2017 – CBA has bowed to public pressure and removed contract terms that allow it to put small business borrowers into default, even if they have not missed a repayment. It will pledge to remove contract terms that allow "non-monetary defaults" by small business customers who have borrowed up to \$3m from the lender.

19 May 2017 – CBA has paid (or offered) \$5,850,827 of (an estimated) \$105,637,587 in compensation for failing to provide general or personal financial advice to customers while charging them ongoing advice fees.⁴

¹ Clancy Yeates and Georgia Wilkins, NAB and Bankwest forced to repay customers: ASIC, *WA Today*, 2 February 2017, <http://www.watoday.com.au/business/banking-and-finance/nab-and-bankwest-forced-to-repay-customers-asic-20170201-gu3mce.html>.

² Jeff Whalley, Payout hits \$23m, *Herald Sun*, 8 February 2017.

³ Anna Patty, Claim CBA owes super millions to employees, *The Age*, 21 February 2017.

⁴ 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service,

3 August 2017 – AUSTRAC initiated civil penalty proceedings in the Federal Court against CBA for serious and systemic non-compliance with the *Anti-Money Laundering and Counter-Terrorism Act 2006*. The proceedings allege over 53,700 contraventions of the Act:

- CBA did not carry out any assessment of the money laundering and counter terrorism financing risk of their Intelligent Deposit Machines before their rollout and took no steps to assess that risk until mid-2015. This was required by the program that CBA had established itself under the requirements of the Act. CBA failed to comply with its own AML/CTF program.
- For 3 years CBA did not comply with requirements to adequately monitor transactions on 778,370 accounts
- CBA failed to give 53,506 threshold transaction reports to AUSTRAC on time for cash transactions of \$10,000 or more through IDMs from 11/2012 to 09/2015
- These transactions represent approximately 95% of the threshold transactions that occurred through CBA's IDMs and had a total value of approximately \$624.7m
- The bank failed to report suspicious matters (either on time or at all) involving transactions totalling over \$77m
- Even after CBA became aware of suspected money laundering or structuring on CBA accounts, it did not monitor its customers to mitigate and manage the risk, including the ongoing money laundering and counter terrorism risks of doing business with those customers.⁵

AUSTRAC alleges that even after CBA became aware of suspicious activity, including being told about it by the AFP, it appears to have permitted accounts to remain open and for transactions to continue flowing through them.

Each breach of the Act carries a maximum penalty of \$18m and a potential fine of \$960bn.⁶

5 August 2017 – One of the money laundering syndicates linked to the CBA compliance scandal worked with drug smugglers who imported methamphetamine worth \$315m, the largest ice seizure in WA history.

The syndicate used CBA to launder more than \$21m according to AUSTRAC.⁷

14 August 2017 – Commonwealth Bank will refund approximately \$10 million to over 65,000 customers after selling them unsuitable credit insurance between 2011 and 2015. The customers were sold 'CreditCard Plus' insurance for credit card repayments, when they were unlikely to meet the employment criteria (i.e. they were unemployed or were students with lower credit limits) and would be unable to claim the insurance.

19 May 2017.

⁵ AUSTRAC, AUSTRAC seeks civil penalty orders against CBA, 3 August 2017.

⁶ James Eyers, AUSTRAC allegations are jaw-dropping, *Australian Financial Review*, 4 August 2017.

⁷ Nino Bucci, Syndicate linked to bank scandal behind \$315 million drug haul, *The Age*, 5 August 2017.

Westpac

15 March 2017 – ASIC accepts enforceable undertaking from Westpac to address “inadequacies” in wholesale FX business. ASIC was concerned that between 1 January 2008 and 30 June 2013, Westpac failed to ensure that its systems and controls were adequate to address the risks relating to instances of inappropriate conduct identified by ASIC. Westpac employees on several occasions disclosed confidential details of pending orders to third parties and identified customers using code names.⁸

25 March 2017 – Head of Wealth Management Martyn Wild, who was responsible for \$34bn of investments in Westpac’s wealth management business, left Westpac on 24 March 2017 after allegations of inappropriate behaviour toward two female staff members. He had previously been disciplined for breaches of Westpac’s code of conduct.⁹

9 May 2017 – APRA will force banks to hand over life insurance claim data by the end of the financial year to impose better standards on the sector. BT Financial Group has a claims rejection rate of 37%.¹⁰

9 May 2017 – Westpac’s wealth management arm BT Financial Group increased the premiums on its in-force life insurance policies by 11% for the six months ending 31 March 2017, while gross written premiums across the general insurance division rose by 2% during the same period.¹¹

19 May 2017 – Westpac paid estimated \$2,670,479 in compensation it owed to customers for failing to provide general or personal financial advice to customers while charging them ongoing advice fees.¹²

8 June 2017 – Sudhir Sinha, a former Westpac financial planner, has been banned from providing services for 5 Years from 2 June 2017. An ASIC investigation established that he systematically failed to meet his ongoing advice service obligations over a period of six years while he was employed by Westpac. As at 28/2/17, Westpac has remediated \$1,473,914 to clients for Mr Sinha’s conduct.¹³

19 July 2017 – ASIC has banned financial adviser Jason Atkins for three years. ASIC found that Mr Atkins provided advice to clients to establish SMSFs and use

⁸ 17-065MR ASIC accepts enforceable undertakings from Westpac and ANZ to address inadequacies within their wholesale FX businesses, 15 March 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-065mr-asic-accepts-enforceable-undertakings-from-westpac-and-anz-to-address-inadequacies-within-their-wholesale-fx-businesses/>.

⁹ Elizabeth Knight and Georgia Wilkins, Senior Westpac executive goes after misconduct, *The Age*, 25 March 2017, <http://www.smh.com.au/business/banking-and-finance/senior-westpac-executive-departs-after-behavioural-misconduct-20170324-gv5shd.html>.

¹⁰ Michael Roddan, Regulator puts life insurance industry on notice of policy checks, *The Australian*, 9 May 2017.

¹¹ Michael Roddan, Insurance claims hit BT Financial’s profit, *The Australian*, 9 May 2017.

¹² 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service, 19 May 2017.

¹³ 17-178MR, ‘ASIC bans former Westpac adviser for five years,’ 8 June 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-178mr-asic-bans-former-westpac-adviser-for-five-years/>.

limited recourse borrowing arrangements to fund the purchase of the properties by their super funds in breach of the FoFA best interests obligation. Mr Atkins was a former corporate authorised representative of Magnitude Group, which is a subsidiary of Westpac from May to December 2015.¹⁴

22 August 2017 – ABC’s *Four Corners* says that it has obtained Westpac’s most recent performance expectations that required lending staff to complete between 6 and 9 home loan requests per week. If targets were exceeded staff could earn bonuses of \$6000 per quarter. Current and former bank staff said that if they did not meet the lending targets, they were “performance managed out of the bank”, according to the report.¹⁵

ANZ

15 March 2017 – ASIC accepts enforceable undertaking from ANZ to address “inadequacies” in wholesale FX business. ASIC is concerned that between 1 January 2008 and 30 June 2013, ANZ failed to ensure that its systems and controls were adequate to address the risks relating to instances of inappropriate conduct identified by ASIC. ANZ employees on a number of occasions, disclosed confidential details of pending orders to third parties and identified customers using code names.¹⁶

19 May 2017 – ANZ has paid \$43,818,571 of an estimated total of \$52,431,572 in compensation for failing to provide general or personal financial advice to customers while charging them ongoing advice fees. The largest component of ANZ’s compensation program related to fees customers were charged for the ‘Prime Access’ service where ANZ could not find evidence of a statement of advice or record of advice for each annual review period.¹⁷

16 June 2017 – Robert Hutchinson, an authorised representative of RI Advice Group Pty Ltd (a subsidiary of OnePath and ANZ) from 14/5/2007-30/11/2012 has been permanently banned from providing financial services.

10 August 2017 – ANZ will pay an additional \$10.5m in compensation to 160,000 superannuation customers for breaches within the OnePath group between 2013 and 2016 mainly in relation to incorrect processing of superannuation contributions and failing to deal with lost inactive member balances correctly.¹⁸

¹⁴ 17-241MR ASIC bans former Magnitude Group adviser, 19 July 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-241mr-asic-bans-former-magnitude-group-adviser/>.

¹⁵ Jonathan Shapiro, Bank staff ‘managed out’ if targets missed, *Australian Financial Review*, 22 August 2017.

¹⁶ 17-065MR ASIC accepts enforceable undertakings from Westpac and ANZ to address inadequacies within their wholesale FX businesses, 15 March 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-065mr-asic-accepts-enforceable-undertakings-from-westpac-and-anz-to-address-inadequacies-within-their-wholesale-fx-businesses/>.

¹⁷ 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service, 19 May 2017.

¹⁸ 17-266MR ANZ pays further \$10.5 million to consumers for OnePath breach, 10 August 2017.

14 August 2017 – ASIC has banned financial adviser Travis Bryon McLean from providing financial services for 5 years. ASIC banned Mr McLean after reviewing his files relating to the period that he was an authorised representative of Millennium3 Financial Services Pty Ltd (2006 to 2014).¹⁹

23 August 2017 – ASIC has permanently banned former financial adviser Neil Bruce Trower from providing any financial services. Mr Trower is a former representative of Millennium3 Financial Services Pty Ltd, which is ultimately owned by ANZ.²⁰

National Australia Bank

3 March 2017 – NAB paid \$25m overall in compensation to victims of dodgy financial advice. \$7m of that went to 102 customers of one former NAB financial planner, Graeme Cowper. Mr Cowper was allowed to resign, paid \$185,000 and given a letter of recommendation.²¹

2 May 2017 – ASIC suing NAB (and Westpac and ANZ) in the Federal Court over alleged manipulation of the bank bill swap rate.²²

19 May 2017 – NAB has paid (or offered) \$4,641,539 of (an estimated) \$5,027,383 in compensation for failing to provide general or personal financial advice to customers while charging them ongoing advice fees. NULIS Nominees (NAB's superannuation trustee) has not paid any of the (estimated) \$34,720,614 that it owes to date.²³

2 June 2017 – Ex-NAB financial planner Patrick Mitchell permanently banned from the financial services industry after pleading guilty to misappropriating \$2.3 million from a client.

He was sentenced to 8 years jail in March after being found guilty of 25 counts of stealing in the course of his role as a financial planner at Garvan Financial Planning, an MLC subsidiary.²⁴

17 July 2017 – Clydesdale Bank (UK) is facing legal action alleging that thousands of small business customers were fraudulently mis-sold a loan product that destroyed their businesses and torched potentially billions of pounds. Clydesdale was wholly owned by NAB between 2002 and 2012. These loans were investigated

¹⁹ 17-270MR ASIC bans Queensland financial adviser, 14 August 2017.

²⁰ 17-277MR ASIC permanently bans former Queensland financial adviser, 23 August 2017.

²¹ Adele Ferguson, 'I'm just a broken-down old shearer' – CBA faces grilling over CommInsure, *Canberra Times*, 4 March 2017, <http://www.canberratimes.com.au/business/banking-and-finance/im-just-a-brokendown-old-shearer--cba-faces-grilling-over-comminsure-20170303-guq7qm.html>.

²² Richard Gluyas, A lose-lose situation, *The Australian*, 2 May 2017.

²³ 17-145MR Compensation update: major financial advisory institutions continue refund programs for fees-for-no-service, 19 May 2017.

²⁴ Georgia Wilkins, Ex-NAB planner banned after stealing \$2.3m, *Canberra Times*, 2 June 2017.

by the UK regulator in 2014, which found that NAB and Clydesdale Bank had behaved badly.²⁵

4 August 2017 – Former NAB financial adviser Shane Thompson has been charged with two counts of forging financial planning documents during the course of his employment at NAB. He was banned in 2016 for 7 years from providing financial services and credit activities.²⁶

Executive accountability and the BEAR

Over the course of the Bank Inquiry it has been made clear that there needs to be an executive accountability scheme which adequately penalises those executives that engage serious misconduct.

This is evidenced by issues such as the Bank Bill Swap Rate rigging allegations levelled against ANZ, NAB and Westpac; the falsification of loan documents by the banks and the wrongful advice provided by bank financial planners to unwitting consumers.

Labor members of the Committee hold serious concerns about the efficacy of the government's proposed Banking Executive Accountability Regime which falls short of the expectations of the community.

Labor acknowledges evidence given to the Parliamentary Joint Committee on Corporations and Financial Services which, similarly to the House Economics Committee, has ASIC oversight powers. In its last hearing with this committee, ASIC acknowledged the obvious shortcomings of the government's proposed BEAR scheme which only seeks to impose penalties on executives in instances of prudential misconduct.

“...we have seen instances of egregious conduct which have been damaging to consumers and where one of the causal factors may have been management failures which don't tip the balance to become a prudential systemic issue and so we would like to have more power to intervene in relation to those.”

When asked the vast majority of consumer conduct related matters are below the threshold in the BEAR, ASIC stated:

“The vast majority of consumer conduct matters are definitely below that threshold... As to whether in the vast majority of consumer problems there's significant failures of management that might justify banning, it's probably still the case that there are a significant number that fall below the prudential threshold.”

²⁵ Adele Ferguson, NAB faces grief from UK lawsuit, *Australian Financial Review*, 17 July 2017.

²⁶ 17-260MR Former NAB adviser charged with forging documents, 4 August 2017, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-260mr-former-nab-adviser-charged-with-forging-documents/>.

ATM Fees

The Labor members of the committee noted that the decisions by each of the four major banks to cut foreign ATM fees were made on a weekend, Sunday 24 September 2017, in very quick succession.

KEOGH: On the day the Commonwealth announced it was removing that fee for non-customers of the bank to use an ATM they did that in the morning. By 1.53 pm ANZ announced it was cutting that fee. By 2.31 pm you [Westpac] announced you were making the same cut, and NAB cut at 3.12 pm.

We acknowledge that, while this was a positive outcome for consumers, all the major banks had done the required background research and modelling to determine that the removal of the bank fee was feasible but that ANZ, Westpac and NAB decided not to implement this change until another bank did.

When asked why the bank had not considered the removal of the fee sooner, Brian Hartzler - Westpac said:

“Frankly, because we think it's a legitimate fee. We know that customers are happy it's gone but, in a broader context, there's been a move for many years to try and remove cross-subsidies in the banking system.”

Similarly, ANZ acknowledged that it was motivated primarily by competitive pressure rather than consumer demand.

Shayne Elliot, ANZ CEO - “We were prepared; we had looked at all the scenarios; we had all the information available. So making the decision wasn't that difficult. We were confronted with a competitor who had done something, so we were able to act really quickly.”

Bankwest workforce in WA

At the end of September the CBA's legislative safeguard, which sought to ensure that Bankwest jobs stayed in WA, lapsed leaving the 3500 Perth-based staff unsure of their future.

When asked whether the CBA had any intention of reducing the number of management branch or staff at Bankwest in Western Australia, the CBA said:

Ian Narev, CBA CEO - “Bankwest will do what every business does – focus on doing the right thing for customers and be efficient. But we don't have wholesale plans to redeploy any of the staff from Bankwest to [Australian Technology Park, Sydney] or other Commonwealth Bank areas.”

The Government Members' Recommendations

The Government members report offers four recommendations. These recommendations yet again miss the mark. They show that this committee's investigations into the banks were designed to distract from the need for a Royal

Commission rather than provide any real answers to the problems facing Australia's banking system.

The first recommendation relates to merchants gaining the ability to send tap-and-go payments from dual-network debit cards through the channel of the customer's choice by 1 April 2018. The recommendation suggests that the Payments System Board should take regulatory action to require this to occur. The Labor members of the committee support this recommendation.

Recommendation 2 asks that the Australian Competition and Consumer Commission analyse the repricing of interest-only mortgages that occurred in June 2017. While recommendation 3 asks that the Government introduce legislation to mandate participation in Comprehensive Credit Reporting as soon as practicable. Recommendation 4 recommends that the Attorney-General review the threshold for transaction reporting because of the AUSTRAC CBA case.

The Labor members of the committee do not oppose these recommendations. The recommendations taken in isolation make sense however when viewed with the overall picture of scandals, rorts and maladministration occurring in the industry make no sense. These recommendations, much like the use of this committee to stave off a Royal Commission, are patently inadequate.

Labor Members Recommendation

In the past two reports the Labor members have made only one recommendation. That the Government take responsibility, stop defending the banks and establish the systematic, thorough and transparent investigation that only a Royal Commission can provide.

Unlike most of the Government member's recommendations, and as with Labor's recommendation for increased accountability for banking executives, this recommendation has been adopted by the Government. Similarly, it has only been a half-hearted fulfilment of what is required.

It was clear from the Prime Minister's and Treasurer's announcement that a royal commission would be held into banking that it was done at the behest of the big four banks, that the terms of reference were drafted in concert with them and that the effectiveness of the royal commission has been neutered by the limited timeframe provided to the Commission to complete its necessary and extensive work. This is in many ways only the royal commission we called for in name only.

On this basis, Labor Members of the House of Representatives Standing Committee on Economics participating in the Review of the Four Major Bank **note** that:

- The Government has now adopted the consistent and singular recommendation of Labor Members that the Government establish a Royal Commission into the big four banks, but has failed to take up the opportunity to conduct a thorough investigation by limiting the timeframe, and with inadequate terms of reference.

- The Government has not adopted many of recommendations made by Government Members participating in the Review of Four Major Banks, demonstrating the futility of the farcical exercise that has taken place over the last 18 months and has only resulted in an ad hoc and inadequate response to the malfeasance of the four major banks.

Labor Members of the House of Representatives Standing Committee on Economics participating in the Review of the Four Major Bank recommend that:

1. The Government appoint more commissioners to deal with the Royal Commissions workload.
2. The Government extend the terms of reference for the Royal Commission to include matters that Labor has been calling for including;
 - Culture of the banks and executive remuneration.
 - Consultation with banking victims' groups .
 - Protections for whistle-blowers.
 - Regulation or oversight and the overall regulatory architecture.
 - Conduct of liquidators where this relates to the financial services sector.
 - Remove the draft term 'And, the Commission may choose not to inquire into certain matters otherwise within the scope of this Inquiry, but any such decision will be the Commission's, alone.'

Hon Matt Thistlethwaite MP
Deputy Chair

Mr Matt Keogh MP

Ms Madeleine King MP