



15 October 2018

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr Fitt

Inquiry into the provisions of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

The Customer Owned Banking Association (COBA) welcomes the opportunity to provide a submission to assist the Senate Economics Legislation Committee (the Committee) in its Inquiry into the provisions of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (the Bill).

COBA is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). Collectively, our sector has \$113 billion in assets, 10 per cent of the household deposits market and 4 million customers.

Customer owned banking institutions account for around three-quarters of the total number of domestic Authorised Deposit-taking Institutions (ADIs).

COBA is pleased that the Committee is conducting the Inquiry, given there is a specific aspect of the suite of proposals is likely to have serious unintended consequences on conducting business in Australia and, ultimately, consumer outcomes.

We oppose the Government's intention to apply design and distribution obligations (DDO) to basic deposit products. Basic deposit products are simple, low-risk and consumers can exit a basic deposit product at any time.

Schedule 1 of the Bill which amends the *Corporations Act 2001* to introduce DDO in relation to financial products. Under the legislative framework governing disclosure, basic deposit products are naturally excluded from the DDO regime but the Government has stated its intention to make regulations to specifically extend the DDO regime to cover basic deposit products¹.

¹ [Explanatory Memorandum](#) to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018. Paragraph 1.34, page 13, refers.

COBA has expressed, on multiple occasions², serious concern with the intention to extend the proposed DDO to basic deposit products because, fundamentally, no policy case has been made to support this extension.

Further to this critical concern, the intended extension *contradicts* with important messaging about the interaction between regulation and competition and *fails to properly recognise* that the existing regulatory framework already provides consumers with a strong level of protection in relation to the use of basic deposit products.

The proposal to extend the DDO to basic deposit products does not pass the test for new regulation outlined in the Interim Report of the Financial Services Royal Commission, i.e. given the existing complexity of financial services regulation, adding a new layer should not be done unless there is a clearly identified advantage.

No policy case has been made

COBA recognises that the proposed DDO aims to reduce the number of consumers buying complex or risky products that do not match their needs and risk appetite.

COBA notes that the proposed DDO has fundamentally been designed to address adverse outcomes from large scale financial investment failures, and poor advice, associated with complex financial products.

- As the Committee is aware, the Financial System Inquiry (FSI) Final Report³, in supporting a DDO proposal, focussed on consumer detriment from financial investment scheme failures.

However, the adverse outcomes are *not associated* with basic deposit products – there have been no such failures in relation to basic deposit products.

Basic deposit products are central in supporting consumer participation in the financial system and the economy, in terms of enabling people to pay in and withdraw funds and execute payment transactions.

Basic deposit products are low-risk and are the simplest and best understood of all financial products. There is no evidence that these products are not being targeted at the right people.

- Indeed, the simple, safe and well-understood nature of basic deposit products is appropriately recognised in the existing regulatory architecture and policymakers have taken considerable care to reduce, as far as possible, the regulatory burden on issuers of basic deposit products.

The only attempt to make a policy case to apply the DDO to basic deposit products appears to have come from ASIC.

In ASIC *Report 353: Further review of term deposits*, released in 2013, ASIC pointed out that “the key risk for investors is that at the end of the term, their term deposit can roll over automatically from a high interest rate to a much lower interest rate”⁴.

- ASIC’s 2013 report followed an earlier review by ASIC in 2009-10, ASIC’s 2010 *Report 185: Review of term deposits*⁵ refers, which found aspects of term deposit product disclosure that were of concern to ASIC.

² COBA [submission](#) to the Treasury of 17 March 2017: *Design and Distribution Obligations and Product Intervention Power: Proposals Paper, December 2016*, COBA [submission](#) to the Treasury of 9 February 2018: *Design and Distribution Obligations – exposure draft bill*, and COBA [submission](#) to the Treasury of 14 August 2018: *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (second draft).

³ Financial System Inquiry [Final Report](#), November 2014, page 199 refers.

⁴ ASIC Report, [REP 353](#) *Further review of term deposits*, released 4 July 2013.

⁵ ASIC Report, [REP 185](#) *Review of term deposits*, released 1 March 2010.

Of critical importance is that ASIC's 2013 report found that industry largely adopted the recommendations from its 2010 report and that "consumer outcomes on rollovers of term deposits have improved by billions of dollars"⁶.

As part of the release of ASIC's 2013 report, ASIC Deputy Chairman, Mr Peter Kell, highlighted that "while term deposits are generally a safe, low-risk investment, they should not be a set-and-forget investment, and investors should still shop around"⁷.

For a term deposit to qualify as a 'basic deposit product', the funds must be available either at-call or at relatively short notice and no more than 31 days' notice⁸. This means that any anyone who is unhappy with the interest rate on their term deposit can withdraw the funds and put them in a different term deposit with a higher interest rate.

In this context, extending the proposed DDO to basic deposit products would be an entirely inappropriate and excessive response to ASIC's 2013 further review of term deposits, which found that industry largely adopted the recommendations from ASIC's 2009-10 report and that consumer outcomes have improved by "billions of dollars".

ASIC's August 2018 submission⁹ to Treasury on the second draft of the Bill, while again pointing out issues with term deposit products (as already pointed out in ASIC's 2010 and 2013 reports), did not disclose that industry largely adopted ASIC's recommendations from its 2010 report and the significant improvement to consumer outcomes. ASIC does not explain in its submission why the DDO should be extended to basic deposit products following the extensive work carried out by ASIC and industry in 2009-10 and 2013.

ASIC's second example of why the DDO should be extended to basic deposit products relates to transaction accounts. The assumption behind ASIC's example is that the risk of a customer using a transaction account that does not perfectly align with their objectives, financial situation or needs is a significant problem and that the solution to this problem is a new layer of complex regulation, including criminal and civil penalty sanctions for contraventions.

It appears that no attempt has been made to identify whether the intended public benefits – such as enhanced consumer welfare – exceed the potential costs of change.

COBA submits that, in relation to basic deposit products, there is no evidence that the proposed DDO would improve consumer outcomes. There is a significant risk that this will detrimentally impact business and ultimately consumer welfare, chiefly in terms of:

- dampening product and service innovation
- reducing agility and speed in product and service development
- inconveniencing consumers with unnecessary complexity, and
- increasing complexity and costs for product and service providers.

Despite the material risks, a clear and considered cost benefit analysis remains absent.

Contradiction with Government messaging about competition

Unnecessarily extending the proposed DDO to basic deposit products, and hence increasing regulatory costs on all ADIs, would ignore the findings of the Government's expert advisers on regulation and competition, chiefly the Australian Competition and Consumer Commission (ACCC), Productivity Commission and Treasury.

⁶ ASIC Media Release, [13-161MR](#) ASIC releases follow-up term deposit report, 4 July 2013.

⁷ Ibid.

⁸ See ASIC Class Order [CO 14/1262] [Explanatory Statement](#).

⁹ Australian Securities and Investments Commission August 2018 [submission](#): *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (second draft).

- The Chair of the ACCC, Mr Rod Sims, recently stressed that “many people instinctively think that more regulation is the answer, but in our experience more regulation can be harmful to consumers, especially in sectors of the economy that are already heavily regulated”¹⁰.
- The Productivity Commission, in its Report on its Inquiry into Competition in the Australian Financial System¹¹ emphasised the following findings in relation to the possible negative impact of regulation on competition in the financial system:
 - “Regulatory settings and the (actual or perceived) interventions of the Australian Government are having a significant impact on competition in the financial system”
 - “Regulation is dense, and it may act against customers’ interests”
 - “Regulatory arrangements can further entrench the market power of those incumbents that have the expertise and resources to cope with regulatory requirements”, and
 - “The balance between competition and stability has failed where ... regulators are insufficiently interested in analysing the costs that their actions impose”.
- The Treasury’s 13 July 2018 submission¹² on key policy issues to the Financial Services Royal Commission also raised concerns about the potential impact of regulatory costs on competition:
 - regulatory costs “...are borne by financial firms and, in turn, by consumers either directly through higher costs for financial products and services, or indirectly through the impact of such costs on competition or innovation in the choice and quality of products and services that consumers can access.”
 - “Regulatory costs impact all firms but can have a disproportionate impact on smaller firms and new entrants.”
 - “...a financial system that is overburdened by regulation will fail to deliver on its objectives of meeting the financial needs of the community...”, and
 - “Poorly targeted interventions can impose high compliance costs that adversely impacts efficiency in the system and may have disproportionate effects on smaller entities and therefore competition.”.

Indeed, extending the proposed DDO to basic deposit products would also contradict the Government’s recent messages about promoting competition, which appear to have been informed by the recent messages from its expert advisers.

- The Prime Minister of Australia, the Hon Scott Morrison MP, in his Address to Australian British Chamber of Commerce¹³ as the then Commonwealth Treasurer, raised his concern that “banking and financial regulation has had a dulling effect on customers”, and how regulation can sometimes be “...designed to protect the regulator rather than the customer...”.
- The Hon Scott Morrison MP, as the then Commonwealth Treasurer, also reaffirmed¹⁴ the Productivity Commission’s Inquiry findings (as above) by emphasising that “...if we want a more competitive banking system then we need customers not being put to sleep with bewildering regulation...”.

¹⁰ [Speech](#) by ACCC Chair, Mr Rod Sims, ‘Companies behaving badly?’, 13 July 2018.

¹¹ Competition in the Australian Financial System Productivity Commission [Inquiry Report](#), No. 89, 29 June 2018. Pages 171, 3, 6 and 75, respectively.

¹² Treasury’s Financial Services Royal Commission [Submission](#) on key policy issues, 13 July 2018. Pages 13 and 30.

¹³ The then Treasurer’s [address](#) to the Australian British Chamber of Commerce, 3 August 2018.

¹⁴ The then Treasurer’s Doorstep [interview](#), Australian British Chamber of Commerce, 3 August 2018.

- Additionally, the then Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, emphasised that "ultimately it is competition – not regulation – that is the best means of ensuring that consumers and investors get value for money in financial products and services."¹⁵.

Contradiction with Royal Commission findings

Extending the proposed DDO to basic deposit products would also contradict important findings by the Hon Kenneth Hayne AC QC, Royal Commissioner into Misconduct in the Banking, Superannuation and Financial Services Industry (the Commissioner), as detailed in his Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission).

The Commissioner has cautioned against unnecessarily increasing the complexity of the regulation of the financial services industry, given the complexity of the present framework and the potential impact on regulators and compliance culture:

- "given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. That should not be done unless there is a clearly identified advantage"
- "The existing law has rightly been described, in at least some respects, as labyrinthine and overly detailed."
- "Regulatory complexity increases pressure on the regulator's resources and may allow entities to develop cultures and practices that are unfavourable to compliance", and
- "regulatory complexity may foster the development of a 'box-ticking' approach to compliance".

The Committee may find useful section 3.1 of the Interim Report which contains, and elaborates on, these findings – this is provided at the Appendix of this submission.

Consumers already benefit from a strong level of protection

COBA emphasises that the present regulatory framework already provides consumers with a strong level of protection in relation to the use of basic deposit products.

It is important to recognise the critical role that Australia's robust prudential regulatory framework and the Financial Claims Scheme (FCS) deposit guarantee play in protecting depositors of ADIs from potential loss.

Parallel to this, it is also important to recognise the critical role of other legislative protections, being the general obligations for AFS licensees under the *Corporations Act 2001*, the external dispute resolution mechanism provided by the Financial Ombudsman Service (FOS), and the requirements of industry codes such as the Customer Owned Banking Code of Practice and the Code of Banking Practice.

COBA submits that the existing consumer protection framework is well understood and operates effectively to protect consumers from potential loss.

To help put this into context, there are tens of millions¹⁶ of basic deposit products held by Australian consumers. However, consumer disputes taken to FOS for external dispute resolution are relatively low for deposit taking and payments systems.

¹⁵ [Media Release](#) from the then Minister for Revenue and Financial Services, *Government takes action to enhance ASIC's capabilities*, 28 March 2018.

¹⁶ As one example, statistics from the Reserve Bank of Australia (RBA) show that at the end of July 2018, there were 36.95 million open debit card accounts. RBA [Debit Card Statistics Table C5](#).

- According to the FOS' 2017-18 Annual Review¹⁷, there were 2,195 accepted disputes about deposit taking (accounting for 8 per cent of all accepted disputes by FOS) and 1,656 disputes about payments systems (accounting for 6 per cent of all accepted disputes by FOS).

COBA emphasises that any deliberation to extend the proposed DDO to basic deposit products should be undertaken only with clear and specific evidence of loss that cannot be addressed under the present legislative framework. However, it does not appear that this important analysis has been undertaken.

Inconsistency with FSI Recommendation

COBA recognises that, the FSI Final Report¹⁸, in recommending a "targeted and principles-based product design and distribution obligation", stated that "simple low-risk products such as basic deposit products would not require extensive consideration, and may be treated as a class with a standard approach to their design and distribution".

- However, there does not appear to be capacity within the Bill to treat basic deposit products as a class with a standard approach.

With that said, because there is no evidence that the proposed DDO would improve consumer outcomes in relation to basic deposit products, the Government should go further than the FSI's proposed "class" treatment by not extending the proposed DDO to basic deposit products.

Indeed, not extending the DDO proposal to basic deposit products would also ensure that continuity is appropriately maintained with the established 'light-touch' treatment of basic deposit products in the regulatory framework.

To ensure that the reforms support good consumer outcomes, COBA urges the Committee to recommend that the Government confirms that it has no intention of using the regulation-making power to capture basic deposit products in the DDO regime.

If you have any questions or comments in relation to our submission, please contact Tommy Kiang, Senior Policy Manager, on [REDACTED] or at [REDACTED]

Yours sincerely

[REDACTED]

MICHAEL LAWRENCE
Chief Executive Officer

¹⁷ Financial Ombudsman Service 2017-18 [Annual Review](#). Page 66 refers.

¹⁸ Financial System Inquiry [Final Report](#), released November 2014. Recommendation 21. Pages 198-199 refer.

Appendix

Section 3.1 of the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry¹⁹

"3.1 Change the law?"

As noted elsewhere in this report, I begin from the premise that breaches of existing law are not prevented by passing some new law that says 'Do not do that'. And given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. That should not be done unless there is a clearly identified advantage. It should be considered recognising that there is every chance that adding a new layer of law and regulation would serve only to distract attention from the very simple ideas that must inform the conduct of financial services entities:

- **Obey the law.**
- **Do not mislead or deceive.**
- **Be fair.**
- **Provide services that are fit for purpose.**
- **Deliver services with reasonable care and skill.**
- **When acting for another, act in the best interests of that other.**

These ideas are very simple. Their simplicity points firmly towards a need to simplify the existing law rather than add some new layer of regulation. But the more complicated the law, the easier it is to lose sight of them. The more complicated the law, the easier it is for compliance to be seen as asking 'Can I do this?' and answering that question by ticking boxes instead of asking 'Should I do this? What is the right thing to do?' And there is every reason to think that the conduct examined in this report has occurred when the only question asked is: 'Can I?'

The existing law has rightly been described, in at least some respects, as labyrinthine and overly detailed. In the blizzard of provisions, it is too easy to lose sight of those simple ideas that must inform the conduct of financial services entities.

It follows that **the regulatory framework does not always assist the regulator to impose discipline on entities. Regulatory complexity increases pressure on the regulator's resources and may allow entities to develop cultures and practices that are unfavourable to compliance.**

Regulatory complexity affects the conduct of banks and other financial services entities. In particular, it affects how legal requirements are interpreted by and for front line staff. Mr David Cohen, Chief Risk Officer of CBA, observed that the accretion of new legal requirements:

has been an additive process and layer upon layer upon layer is introduced, is absorbed. Rules and policies are set around that new layer. And it is sometimes difficult to distil the very essence of the fundamental obligations out of all of that set of policies, procedures, processes, etc.

In particular, as noted above, regulatory complexity may foster the development of a 'box-ticking' approach to compliance, in which entities develop and focus on internal procedures intended to fulfil various complicated legal obligations, not only at the expense of considering the circumstances in each matter on their merits but also at the expense of measuring what is proposed against those simple ideas that must inform the conduct of all entities in the financial services industry."

¹⁹ Section 3.1 of the [Interim Report](#) of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Volume 1, section 3.1. Pages 290-291 refer.