AUSTRALIAN BANKERS' ASSOCIATION INC.

Strong banks – strong Australia

Inquiry into Competition in the Australian Financial System

ABA submission

15 September 2017

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Executive summary

Australia has a strong and competitive banking industry that underpins the stability of the financial system, supports the economy and provides Australians with products and services to help them save, achieve their financial goals and provide for their retirement.

The Australian Bankers' Association (**ABA**) recognises the importance of a sound regulatory framework that achieves a balance between the competing aims of promoting financial stability, competition, consumer protection, innovation and economic growth. Australia's experience through the global financial crisis (**GFC**) has been due to prudent management of banks, strong regulation administered by regulatory authorities and decisive action by successive governments to support the economy.

The ABA does not believe there are widespread systemic issues in the banking system or regulatory framework that hinder competition. Nor do we believe further regulation is the path to greater competition.

Product markets are competitive, giving customers access to a choice of products. Competitive tensions drive efficiency through price competition which also benefits shareholders through better returns.

However, there is scope to alter existing regulatory settings to enhance competition for the benefit of customers. For example, opportunities exist to enhance competition among existing institutions through enhancements to prudential regulation. Scope exists to encourage greater collaboration with new players through innovation policy which does not result in regulatory arbitrage or undermine consumer protections.

The ABA consists of 24 banks including the major banks, regional banks, foreign banks operating in Australia and customer-owned banks. Given the differences in the scale and operations of our members, it is inevitable that from time to time the interests of members may not align, but this is the exception rather than the rule.

Overall, the industry as a whole has a common interest in joint representation on a range of issues, including regulatory changes underway across the industry. This submission recognises policy issues where views differ within the ABA membership. These differences are a matter of nuance only, rather than fundamental.

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Principles of competition

The ABA and our members embrace competition, noting that like all industries, competition in the banking industry benefits not just customers, but the broader economy and society. As is widely acknowledged, it is also important to ensure the banking industry is not only competitive and efficient, but stable.

Australia's banking system has enabled customers to access a wide range of innovative products and services that are competitively priced. It has also been the cornerstone of the efficient operation of Australia's economy and financial stability over the long term, and especially over the past decade. Banks have continued to access domestic and international funding markets to ensure efficient and cost effective capital mobilisation for the benefit of individual and small business customers.

The ABA welcomes the Government's intention to foster greater competition in banking, although we believe that Australia already has a competitive banking industry and that additional regulation is not the path to enhancing competition. Additional regulation will stifle competition, hinder efficient and cost effective capital mobilisation, and ultimately result in higher transaction costs for all bank customers.

The ABA encourages the Productivity Commission (**PC**) to calibrate the existing regulatory environment to encourage competition through four principles:

Focusing on delivering the best customer outcomes

The ultimate aim of competition is to provide customers with choice so they can access the best products and services appropriate for their needs and circumstances.

The ABA's members believe all proposed reforms should carefully analyse the benefits and costs likely to accrue to individual and small business customers as well as the broader economy. Government and regulatory authorities should place the customer outcome at the centre of all regulatory reforms. Regulatory authorities should also consider the impact of reforms over the economic cycle, not just at a point in time.

Protecting customers and maintaining financial stability through appropriate barriers to entry

The ABA's members believe regulatory barriers to entry in banking are justified where they exist to protect depositors' and borrowers' interests. This underpins the broader stability of the financial system and fosters the prosperity of the Australian economy.

The ABA believes that existing regulatory barriers to entry including licensing, capital requirements, regulatory compliance and security requirements, are broadly appropriate. The current level of regulation generally balances competition with protecting consumers' interests and financial stability. However, we have concerns around the existing level of regulation on shadow banking activities, like safeguards for customers of payday lenders and investors in 'bank-like' products.

There may be some scope to ease certain barriers to entry through initiatives like regulatory sandboxes, provided these reforms appropriately balance competition with consumer and financial stability protections. However, caution must be exercised especially where this puts at risk consumers who may not understand the different business models, investment risks and protections and where the banks are called on to utilise their capital strength to provide safeguards across the financial system.

Ensuring regulation delivers competitive neutrality

The ABA's members take the general view that the economy is best served by clear and consistent principles-based regulation that does not favour one set of participants over another without well founded justification. A fair, flexible and appropriate regulatory environment is the best way to encourage competition and consumer protection.

Encouraging innovation

The ABA's members believe that governments and regulatory authorities should not impede innovation that benefits customers, subject to the appropriate management of risks. Governments should be agnostic on where innovation originates and should ensure that policies to encourage innovation are available to all and regulation takes an activities-based approach.

The ABA's positions and recommendations

Competition and consumer outcomes

- The ABA supports a whole-of-government approach to innovation policy with strong industry engagement across institution type to ensure sound and innovative policy settings are encouraged, and to facilitate collaboration between existing institutions, firms and new entrants.
- The ABA believes the full benefits of open data, including greater competition for customers will rely upon a sound regulatory foundation that addresses privacy and liability concerns. Industry should also be given the opportunity to develop the security and data standards. The ABA's members are devising a path forward for open banking as part of the ABA's response to the Farrell Inquiry.
- The ABA believes the NPP is an excellent demonstration of how industry collaborating together with regulators can lead to positive customer outcomes.
- The ABA is incorporating a number of reforms into the new Code of Banking Practice as well as separately working on reforms to facilitate easier bank switching. These new code obligations include:
    - Accounts to be closed when requested without delay.
    - Banks to provide a list of recurring payments on all accounts to the customer on request.
    - The provision of clearer and more accessible information on how to close accounts, across channels, such as on online and in branches.

  These new obligations complement the existing code obligation on banks to promptly process cancellations for direct debits on banking services (noting that compliance and process matters have been raised in the past).

  The ABA is also working with card schemes to identify potential solutions to enable banks to carry out customer requests to cancel recurring payments transactions on credit cards. Banks will work with card schemes on the system build, cost, and time required to implement this solution.

  In addition, the Australian Payments Network (formerly the Australian Payments Clearing Association) is putting in place measures to reduce the turnaround time to 3 days for the switching facility under which a new financial institution will do the work of switching regular direct debits and credits from the old account.
- The ABA supports the work underway by Treasury to introduce a product design and distribution obligation, and a product intervention power, and will continue to liaise with Treasury. The ABA's members await the Government's legislation in this area.
- The ABA believes the FOFA reforms for financial advisers on complex financial products and ASIC's guidance provide protection for consumers to ensure they receive appropriate advice.
- The ABA believes the Future of Financial Advice (**FOFA**) reforms for financial advisers, coupled with the new professional standards framework for financial advisers and ASIC's regulatory guidance on the offer of complex products, provide protection for consumers to ensure they receive financial advice in their best interests. Once the new professional standards framework for financial advisers commences and the new standards are set, the ABA's members support the Financial Adviser Standards and Ethics Authority (**FASEA**) administering the training requirements for other financial services professionals.

- The ABA believes the definition of financial product advice should be reviewed. We support the clarification of the term 'general advice', however, consider that a more fulsome consideration of financial advice is needed to ensure the law keeps up with consumer expectations about what and how they receive advice.
- The ABA supports more innovative disclosure, including removing regulatory barriers to better utilising technology and digital disclosure that will see the costs of producing (and printing) disclosure documents reduce, while making them clearer and easier to navigate, and therefore more likely to be understood by consumers. The ABA's members await further consultation on FSI recommendation 23 and support work by Treasury being prioritised on this area.
- The ABA supports reforms to improve remuneration structures, governance practices and transparency in banking and financial services. Banks are actively working with lenders, aggregators and brokers to develop an industry response for improving remuneration structures, governance practices and disclosure of ownership structures in mortgage broking.
- The banking industry has committed to implementing the recommendations of the 'Sedgwick Review', covering changes to remuneration and incentives for bank employees, governance and performance management systems, and payments to third parties, including mortgage brokers.
- The ABA's Banking Reform Program is a self-regulatory initiative for the banking industry, with the objectives of improving products, service and culture in banking. However, the ABA is mindful that regulatory reforms, particularly those relating to consumer or financial stability protections should be designed and implemented across the entire financial services industry. Inconsistent standards and practices puts at risk consumers who may not understand when they deal with non-banks that they may not have the same protections.
- The ABA believes that all financial institutions should be inclusive in dealing with all customers and providing a range of options so customers can choose the most appropriate banking products and services for their needs and circumstances.
- The ABA believes that ASIC's powers should be strengthened and clarified to ensure financial services providers are required to have and maintain adequate financial requirements and compensation arrangements to obtain and hold an Australian Financial Services (**AFS**) licence. While the ABA strongly supports the introduction of a new mandatory and prospective last resort compensation scheme for financial advice, it is inappropriate to expect banks to cover consumer losses due to the illegal or poor conduct of non-banks.

Reducing barriers to entry and encouraging innovation

- The ABA would encourage the PC to look at the prudential and public policy implications, including consumer protections arising from the changing landscape of banking, i.e. the entry of new fintech players and firms, especially those not adopting industry standards and codes, such as the e-Payments Code.
- The ABA recommends that the regulatory sandbox be modified to be made more accessible for market participants and ensure that the modifications encourage collaboration between existing institutions and start-ups.
- The ABA supports modifying the capital requirements required to use the term 'bank' provided that APRA continues to use discretion when required.
- The ABA supports modifying restrictions on the requirements to use of the term 'bank' provided APRA continues to use its discretionary powers when appropriate.

- The ABA supports a review of licensing to streamline new entrants' regulatory processes. However, all financial services providers and credit providers should be required to maintain adequate financial requirements and compensation arrangements to ensure appropriate consumer protections.

Ensuring regulation delivers competitive neutrality

- The ABA strongly recommends that the PC should take into consideration the likely impact of the finalisation of the Basel III changes if it decides to make recommendations regarding the capital framework. We also believe that any recommendations should be made in collaboration with APRA and Treasury.
- The ABA recommends the PC should consider how the prudential framework for authorised deposit-taking institutions (**ADIs**) creates a distortion in that non-ADI lenders are able to compete without any of the prudential oversight that ADIs are subject to, for example shadow lenders.
- APRA should consider the effects of its mortgage reforms on both ADIs and shadow banking sector. The caps on investor loan growth have restricted the ability of ADIs to competitively grow investor loan portfolios and opened opportunities for non-ADI lenders. The ABA asks that the PC considers how this has affected competition between players within the market.
- The ABA supports the FSI observation around improving the accreditation process to move to internal risk-based models. We believe that APRA could proactively partner with standardised approach banks who are seeking internal model accreditation to ensure the process is as seamless as possible.
- The ABA asks that the Government confirms its support for all Australian ADIs in periods of crisis. We ask that the PC also acknowledges the impact on the likelihood and extent of any government assistance that would be needed from reforms to strengthen the banking industry, like total loss-absorbing capacity (**TLAC**), crisis resolution, unquestionably strong reforms, as well as the RBA's committed liquidity facility (**CLF**). Articulation of the Government's commitment to ADIs is needed in light of the credit ratings agencies' perception of differing levels of government support between Australian ADIs and the consequent impact on their credit ratings.
- The ABA is supportive of the crisis resolution reforms and strongly believes that adequate consultation (greater than the 21 days provided by Treasury) on the exposure draft legislation would have been preferred to yield a well-designed Australian regime that works together with existing prudential frameworks, efficiently implemented to support the financial system and achieve the consumer outcomes intended without complex and costly unintended consequences.
- The ABA supports increased powers to APRA to ensure that shadow banks are monitored effectively.
- The ABA supports the Government's strong response to payday lenders and believes further action is warranted.
- The ABA supports ensuring important consumer and financial stability protections apply not just to banks, but other entities that participate in the same financial markets. This will ensure the same standards apply to regulated entities and consumers are not exposed to different practices and safeguards by institutions and firms offering the same products, particularly where consumers may not be aware of these differences.
- The ABA would welcome the PC's analysis of the extent and likely impact of ongoing regulatory reform and its economic impact, especially on smaller ADIs.

Encouraging individuals to save and plan for their future

- The ABA believes that the superannuation system could be improved through targeted reforms to support operational efficiencies and reduce administration costs as well as promote financial literacy for all superannuation members.

1. The competitive environment in Australian banking

The Australian financial system is competitive. A large number of financial entities offer a wide variety of financial services and products. The major banks tend to dominate the landscape, but the market space is strongly contested by other banks, by other ADIs and by new entrants with different business models and technologies.

Competition is strong across the banking and financial services industry, including deposit products, credit cards, lending for housing and lending to businesses.

The major banks' solid profitability contributes to a resilient financial system and ensures Australian banks can access domestic and international funding markets. The major banks are not unusually profitable when compared to peers in similar economies, such as Canada. Solid profitability also contributes to the savings and retirement funds of Australians. Access to banking services has never been higher and customer satisfaction with banks is also high.

The banks are strong innovators, which helps drive Australia's economic efficiency and productivity. They deliver higher living standards, in good returns for Australian households through their shareholdings, either directly and through their superannuation.

This chapter outlines key data on Australia's banking industry.

1.1 Industry structure

Australia has a large number of financial institutions offering a range of financial services to customers.

Australia had 152 ADIs regulated by APRA in 2016, as well as alternative providers of financial services such as peer-to-peer lenders and non-deposit taking institutions.

The GFC had a lasting effect on the structure of financial systems in Australia and overseas. Although there were no bank failures in Australia, unlike other advanced economies, the GFC led to a significant rationalisation of ADIs, with the number declining by 80 over the 10 years to 2016. This went hand in hand with a rise in the number of banks, with banks now the most common type of ADI. Much of this change was a result of credit unions and building societies becoming banks. There was also a solid rise in the number of branches of foreign banks in Australia.

Figure 1: Number of Authorised Deposit-taking Institutions (ADIs)

	2004	2008	2012	2016
Major banks	4	4	4	4
Other domestic banks	9	7	13	26
Foreign subsidiary banks	10	9	8	7
Foreign branch banks	27	35	41	45
All banks	50	55	66	82
Building societies	14	11	9	4
Credit unions	171	122	91	58
Other ADIs	7	8	7	8
All ADIs	242	196	173	152

Source: APRA

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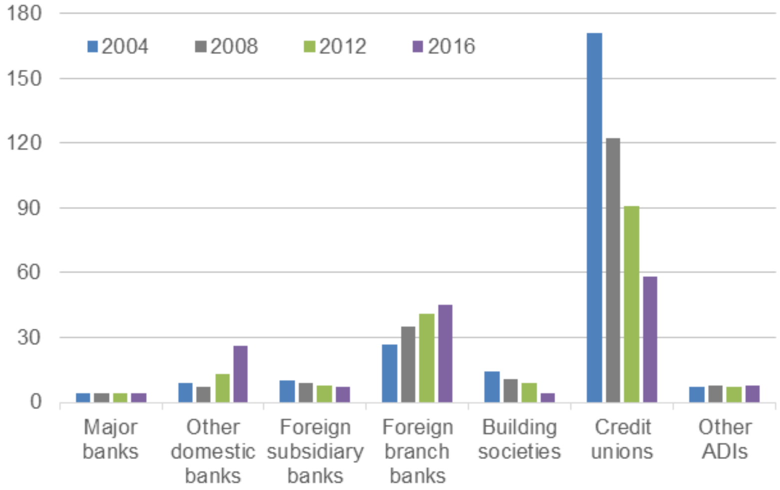
Figure 1.2: Number of Authorised Deposit-taking Institutions (ADIs)



Source: APRA

One approach to assessing the effects of these changes on competition is to consider those seen in the distribution of the $4.6 trillion in assets held by ADIs.

In the years immediately following the GFC (between 2008 and 2012), there was a moderate increase in the proportion of total ADIs' assets held by the four major banks from around 72 to 78 per cent. This was primarily due to bank mergers; the CBA purchase of the bank of Western Australia (Bankwest) and St Andrews Australia (St Andrews) from HBOS in October 2008, and the merger of St George and Westpac in December 2008.

The dominance of the majors has declined slightly since 2012. Although they remain the most significant players in the financial system, no single institution has more than a 25 per cent share of the market.

The share held by building societies and credit unions declined as institutions converted to banks.

Figure 1.3: Assets of Authorised Deposit-taking Institutions (ADIs)

	2004	2008	2012	2016
Assets ($m)				
Major banks	1,280.805	2,443,386	2,841,103	3,560,261
Other domestic banks	199,900	298,116	313,053	460,128
Foreign subsidiary banks	100,486	103,500	112,047	121,275
Foreign branch banks	159,717	431,738	301,820	436,749
All banks	1,740,907	3,276,739	3,568,023	4,578,412
Building societies	15,494	21,024	22,478	12,554
Credit unions	32,295	45,421	47,338	37,648
Other ADIs	9,123	9,671	7,570	4,234
All ADIs	1,797,819	3,352,855	3,645,408	4,632,848
Distribution				
Major banks	71.2%	72.9%	77.9%	76.8%
Other domestic banks	11.1%	8.9%	8.6%	9.9%
Foreign subsidiary banks	5.6%	3.1%	3.1%	2.6%
Foreign branch banks	8.9%	12.9%	8.3%	9.4%
All banks	96.8%	97.7%	97.9%	98.8%
Building societies	0.8%	0.6%	0.6%	0.3%
Credit unions	1.8%	1.4%	1.3%	0.8%
Other ADIs	0.5%	0.3%	0.2%	0.1%
All ADIs	100.0%	100.0%	100.0%	100.0%

Source: APRA

The relatively high degree of concentration in Australia’s banking system is confirmed by the two measures of concentration by the World Bank as part of the World Bank’s Global Financial Development database.[1]

The Bank Concentration Index measures the concentration as the share of the assets of the three largest banks in total banking industry assets. On this measure, Australia has relatively high concentration although the highest concentration of banking is in Sweden, Norway and the Netherlands.

[1] http://databank.worldbank.org/data/reports.aspx?source=global-financial-development

Figure 1.4: Bank concentration index (%)

	2005	2014	2015
Australia	82.1	70.1	71.6
United Kingdom	54.5	50.4	48.4
United States	29.9	36.0	34.9
Canada	86.5	59.0	60.3
Germany	72.9	76.6	74.8
Netherlands	85.3	87.0	88.0
Sweden	96.9	94.2	94.3
Norway	89.1	94.2	93.3
China	62.5	44.4	42.4
Japan	37.2	46.3	45.9

Source: World Bank

The Reserve Bank of Australia (**RBA**) has also undertaken similar analysis to the World Bank's Five Bank Asset Concentration which shows that while Australia has a concentrated financial system, Sweden, Canada and the Netherlands have more concentrated financial system.[2]

RBA Governor Phil Lowe noted in testimony to Parliament in September 2016 that "most banking systems are now very heavily concentrated" following the global financial crisis which led to a number of mergers around the world. The Governor said "we are not unusual in having four or five banks that account for the vast bulk of financial intermediation."[3]

The World Bank notes that bank concentration is often used as an indicator of bank competition "for lack of a better alternative".[4] They note the competitive environment is also influenced by bank regulations, such as restrictions on entry, exit, and bank activities, as well as consumer preferences. In other words, concentration does not necessarily point to a low level of the contestability of the financial markets, or the ability of consumers to shop around for a better deal and the degree of barriers to new banking entrants.

It is also worth noting that as a small open economy with a large geography, Australia has oligopolies in several industries including supermarkets, airlines, and telecommunications companies.

1.1.1 Other lenders

In addition to the ADI sector, there are a range of alternative lenders and providers of financial services.

"Shadow banks" are entities which can provide similar lending services to banks but are not regulated ADIs. Data are a little dated but suggest the Australian shadow banking sector is quite small, at less than five per cent of total financial sector assets. This places it at the lower end of international comparisons.

While data are limited, the ABA believes that shadow banking activities in Australia have risen since 2014 as a share of the financial system.

[2] https://www.rba.gov.au/publications/submissions/bank-fees-and-margins/handout-standing-committee-on-economics-2016-09-22/

3 Dr Philip Lowe, Governor of the RBA, Transcript, 22 September 2016, p. 17.

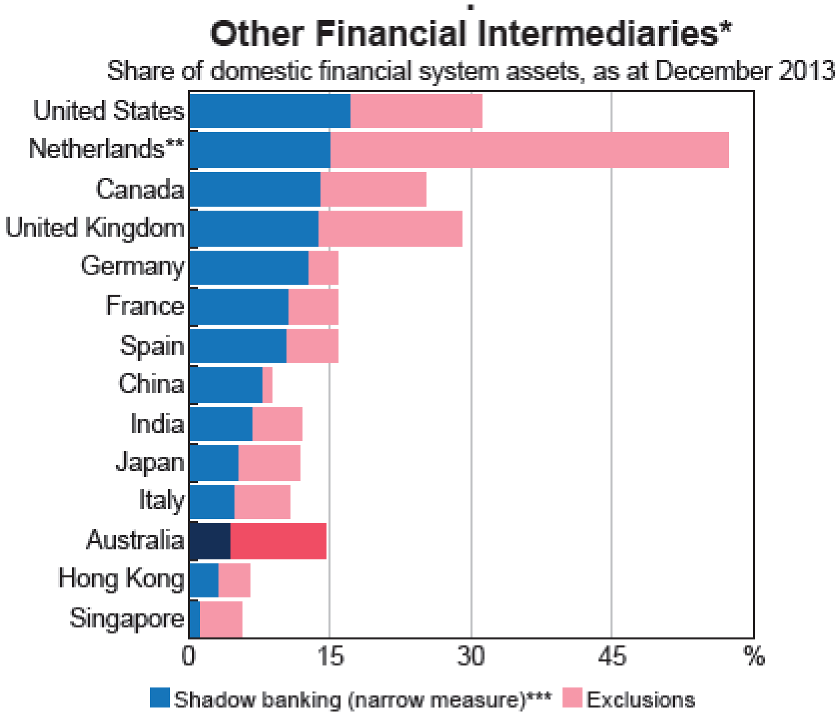
[4] http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/0,,contentMDK:20346985~pagePK:64165401~piPK:64165026~theSitePK:469372,00.html

Figure 1.5: Australian financial sectors composition by entity type
Share of financial system assets (%)

	2002	2007	2014
Total prudentially regulated	76	79	85
ADIs	49	52	55
Superannuation funds	23	24	27
Insurers	4	3	3
OFIs	24	21	15
Structured finance vehicles	6	6	7
Finance companies	4	3	2
Money market	4	2	1
Cash management trusts	1	1	0
Other investment funds	8	9	5
Shadow banking	11	10	4
Excludes			
* Self-securitisation	0	0	5
* Equity REITs	3	4	2
* Equity funds	4	4	2
* Prudential consolidated assets	6	4	2

Source: RBA

Figure 1.6: Global indicators of shadow banking

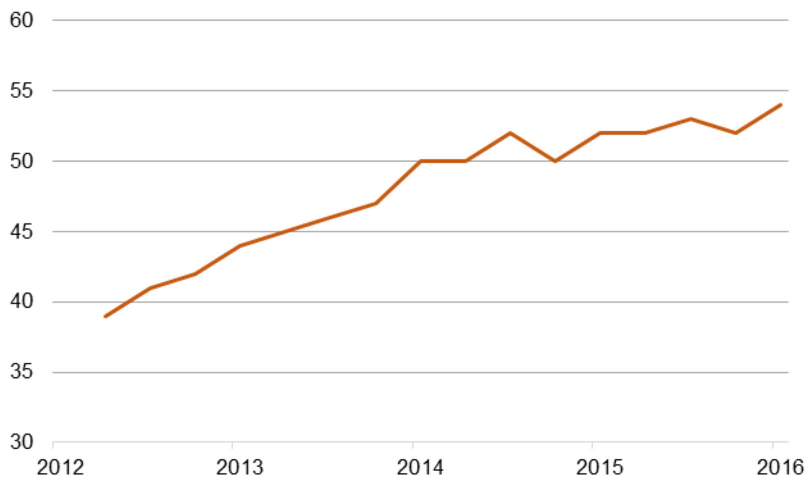


Source: RBA

The degree of contestability of the Australian financial system has been shown from time to time by the entry of new players with new business models and processes.

The emergence of mortgage originators in the 1990s, largely funded by securitisation of mortgages, was a key development. Today roughly half of mortgages are originated by brokers.[5]

Figure 1.7: Mortgage broker share of housing loan commitments (%)



Source: Macquarie Research

1.1.2 Full service banking

Australia's $2.3 trillion superannuation industry is also competitive with almost 2,300 corporate funds, retail funds, and industry funds regulated by APRA, and with close to 600,000 self-managed superannuation funds. Banks participate in the superannuation industry through ownership of key retail funds. However, they do not dominate, with retail funds in total comprising only around a quarter of assets under management. Superannuation and wealth management offered through banks provides customers with the convenience of a 'one stop shop' for their banking and financial services needs. Banks have developed interactive platforms to provide value-added, customer tailoring options and innovative advisory services.

[5] https://australiancentre.com.au/wp-content/uploads/2015/10/Commissioned-paper-Trends-in-the-Australian-small-loan-market.pdf

Figure 1.8: Superannuation – assets and entities

	Assets ($bn)		Distribution	Number of entities	
Superannuation entities	Mar-16	Mar-17		Mar-16	Mar-17
APRA-regulated					
. Corporate	$54	$59	3%	31	30
. Industry	$447	$518	23%	42	41
. Public sector	$216	$243	11%	20	19
. Retail	$532	$580	26%	140	131
Sub-total: Entities with 4+ members	$1,248	$1,399	62%	233	221
Single-member ADFs	$0	$0		36	12
Small APRA funds	$2.0	$1.9		2,192	2,066
Total APRA-regulated	$1,250	$1401	62%	2,505	2,341
ATO-regulated (SMSFs)	$598	$675	30%	568,506	590,742
Other					
. Exempt schemes	$129	$129	6%	19	19
. Balance of life office funds	$55	$55	2%		
Total	$2,032	$2,259	100%	571,030	593,102

Source: APRA

1.2 Competition within product markets

1.2.1 Market share

Customers can access a wide choice of financial institutions and financial products.

The key observations on competition in product markets are:

- The major banks' (which include subsidiary brands) share of total loans and advances rose post-GFC, but has been broadly stable since 2012.
- Other domestic banks have gradually gained market share since the GFC, but this has been at the expense of branches and subsidiaries of foreign banks.
- The major banks' share of lending for housing has declined slightly since the GFC although they remain the predominant lenders for housing with over 80 per cent of the market.
- Other domestic banks have recorded positive gains in their share of the housing market and now provide over 11 per cent of the market. That is partly the result of the conversion of credit unions and building societies to banks, although the aggregate data suggest that probably no more than half of the gains by other domestic banks reflect conversions.
- Foreign bank branches have recorded strong *percentage* gains in lending for housing although the *$ value* of this lending remains small.
- The institutional shares of the deposit market are broadly in line with the shares of the lending market, with other domestic banks recording the strongest growth.

Figure 1.9: Lending and deposits of ADIs

	2004	2008	2012	2016	2004	2008	2012	2016
	$million				Share %			
Loans and advances								
Major banks	857,110	1,530,594	1,888,987	2,460,172	74.3%	76.7%	80.6%	80.3%
Other domestic banks	134,208	152,683	197,897	300,655	11.6%	7.7%	8.4%	9.8%
Foreign subs	72,694	77,454	87,901	98,982	6.3%	3.9%	3.8%	3.2%
Foreign branches	51,491	183,866	112,741	163,245	11.1%	9.2%	4.8%	5.3%
Building societies	12,092.7	15,741	17,984	10,344	1.0%	0.8%	0.8%	0.3%
Credit unions	26,039	35,368	38,114	30,507	2.3%	1.8%	1.6%	1.0%
Total	1,153,635	1,995,706	2,343,624	3,063,904	100%	100.0%	100.0%	100.0%
Housing								
Major banks	465,685	877,516	1,180,797	1,549,736	77.0%	84.7%	83.7%	83.3%
Other domestic banks	74,037	69,218	124,661	208,409	12.2%	6.7%	8.8%	11.2%
Foreign subs	35,793	47,020	55,324	64,329	5.9%	4.5%	3.9%	3.5%
Foreign branches	51	37	52	319	0.0%	0.0%	0.0%	0.0%
Building Societies	10,416	13,814	16,429	9,929	1.7%	1.3%	1.2%	0.5%
Credit unions	19,131	28,989	33,616	27,726	3.2%	2.8%	2.4%	1.5%
Total	605,112	1,036,593	1,410,878	1,860,447	100.0%	100.0%	100.0%	100.0%
Deposits								
Major banks	660,966	1,275,727	1,696,535	2,128,095	70.7%	76.1%	80.0%	79.5%
Other domestic banks	111,567	130,072	183,964	271,100	11.9%	7.8%	8.7%	10.1%
Foreign subs	67,099	76,175	83,387	99,309	7.2%	4.5%	3.9%	3.7%
Foreign branches	54,237	137,087	97,961	137,824	5.8%	8.2%	4.6%	5.1%
Building Societies	13,674	17,886	18,884	10,062	1.5%	1.1%	0.9%	0.4%
Credit unions	27,841	38,930	39,999	32,046	3.0%	2.3%	1.9%	1.2%
Total	935,384	1,675,877	2,120,730	2,678,436	100.0%	100.0%	100.0%	100.0%

Source: APRA

1.2.2 Deposit products

The Canstar listing shows 82 financial providers of 1,204 deposit products.

Banks have just over half (51 per cent) of the deposit product listings. Major banks account for 158 products or 13 per cent of deposit product listings.

Figure 1.10: Deposit products

	Products	%
Banks	619	51.4%
. Major banks	158	13.1%
. Regional banks	44	3.7%
. Other banks	417	34.6%
CUBS	560	46.5%
Other	25	2.1%
Total	1204	100.0%

Source: Canstar

1.2.3 Mortgage products

The market for home loans is very heavily contested. The Canstar database lists 106 institutions with 4,019 home loan products. There are 2,259 (56 per cent) variable loan products and 1,760 (44 per cent) fixed loan products. Banks have just over half of the Canstar home loan product listings. Major banks have about one-fifth of home loan product listings.

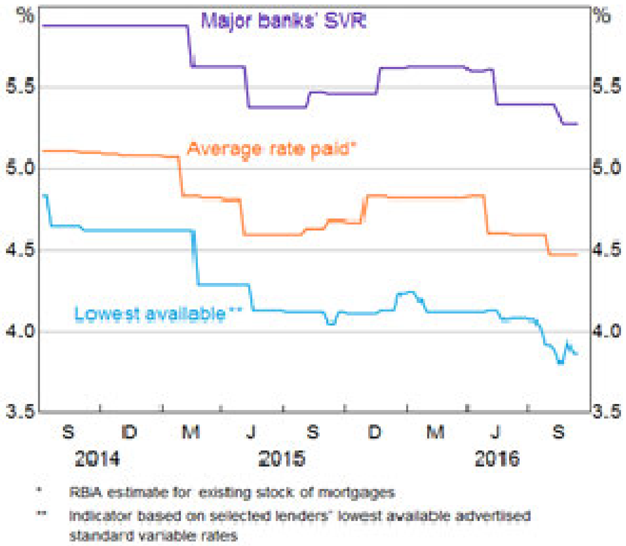
Figure 1.11: Mortgage products (number)

	Fixed	Variable	Total
Banks	1,204	886	2,090
Major banks	450	309	759
Regional banks	141	91	232
CUBS	524	515	1,039
Other	531	359	890
Total	2,259	1,760	4,019
%Distbn			
Banks	53.3%	50.3%	52.0%
Major banks	19.9%	17.6%	18.9%
Regional banks	6.2%	5.2%	5.8%
CUBS	23.2%	29.3%	25.9%
Other	23.5%	20.4%	22.1%
Total	100.0%	100.0%	100.0%

Source: Canstar

Using indicator mortgage interest rates is not a sound basis of analysis to look at price competition in mortgage lending markets. The RBA recently undertook analysis which highlights the extent of discounting that takes place on mortgage interest rates, which Governor Lowe presented to Parliament. He noted that the spread between the benchmark standard variable rates and the lowest available advertised rates has increased in recent years. The difference reflects both advertised and unadvertised discounts. It is not unusual for the discounts to be up to 1.5 percentage points.

Figure 1.12: Variable Housing Interest Rates



Sources: ABS, APRA, Canstar, Perpetual, RBA

1.2.4 Business lending

Competition to lend to businesses is strong. Canstar lists 22 institutions providing 191 business loan products for both small and large businesses. Banks, particularly the majors, tend to dominate the market, in part because they have the required systems and expertise in assessing and pricing business risk.

Figure 1.13: Business lending products (number)

	Fixed		Variable		Total	
	Products	Avg rate (%)	Products	Avg rate (%)	Products	Avg rate (%)
Banks	37	5.38	114	6.93	151	6.56
Major banks	26	5.33	77	6.67	103	6.34
CUBS	10	5.33	19	6.84	29	6.32
Mutual banks	2	4.99	6	5.91	8	5.68
Other	1	8.50	2	4.65	3	5.93
Total	50	5.42	141	6.84	191	6.47

Source: Canstar

Most business loan products (65 per cent) are below 7 per cent. In fact, just over half (52 per cent) of loan products are below 6 per cent. There are no consistent differences in the pricing of business loans between types of institutions.

1.2.5 Credit cards

The Australian credit card market is very competitive.

A large range of credit card products exists, ranging from higher interest rate cards with attractive additional features such as long interest free periods and rewards points, to “no frills’ low interest rate cards with less additional features. All types of institutions offer a variety of cards. Close to one-third of cards have an interest rate under 14 per cent.

Figure 1.14: Credit card products (number)

	Major bank	Regional bank	Other bank	Total – bank	CUBS	Other	Total
Gold	3	1		4		6	10
Platinum	32	5	15	52	3	10	65
Standard	31	6	7	44	28	9	81
Affinity			1	1			1
Total	66	12	23	101	31	25	157

Source: Canstar

Figure 1.15: Credit card products by interest rate (number)

Interest rate range	Bank	CUBS	Other	Total
Under 10%		5		5
10% to 11.99%	5	12	2	19
12% to 13.99%	18	8		26
14% to 15.99%	3	2	1	6
16% to 17.99%	2			2
18% to 19.99%	42	2	2	46
20% to 21.99%	30	2	13	45
Over 22%	1		3	4
Total	101	31	21	153

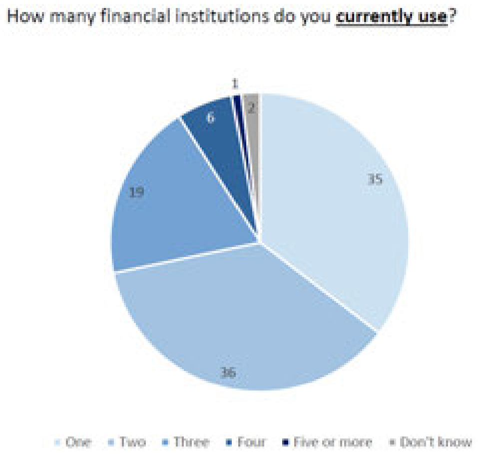
Source: Canstar

1.3 The customer experience

Polling by Galaxy Research on behalf of the ABA of 1,000 Australians in August 2017 demonstrates that customers are empowered and shop around for the best deal on product suitability and price.

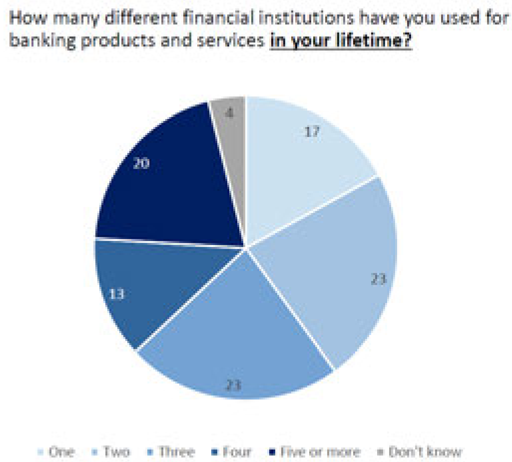
The notion that customers stay with an institution over their life is a false. More than four in five Australians have moved financial institutions in their life and two-thirds of Australians currently have a relationship with more than one financial institution, with around 30 per cent holding a relationship with three or more.

Figure 1.16: Customers' current relationships with financial institutions



Source: Galaxy Research

Figure 1.17: Customers' relationships with financial institutions over their lifetime



Source: Galaxy Research

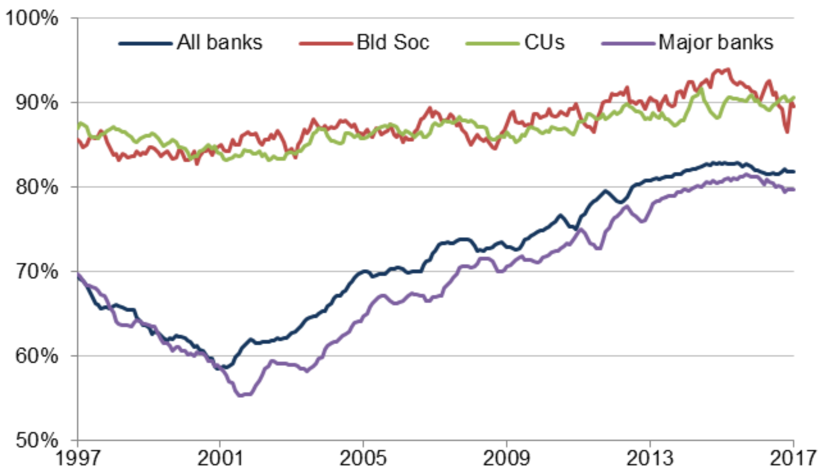
Customers report they choose their financial institution based on price, i.e. fees and interest rates. Importantly, perceptions of financial strength of an institution also drive consumer preferences, with around two-thirds of those polled reporting that a "strong and safe place to keep my money" is a high priority when choosing an institution. Other important factors include access, such as ATMs, technology, branches and customer service.

Figure 1.18: Factors affecting choice of a financial institution

Source: Galaxy Research

Customer satisfaction with banks is close to historically high levels. It is lower than for smaller competitors, such as building societies and credit unions, although banks have substantially closed the gap in recent years.

Figure 1.19: Customer satisfaction



Source: Roy Morgan Research

Australia has a high level of customer points of presence, with a relatively high number of bank branches per head. The availability of ATMs is also relatively high though not as high as in Canada. The relatively high number of branches and ATMs reflects the need to provide banking services to a population spread sparsely across a large geography.

Branches and ATMs are only partial indicators of the availability of banking services, with banking increasingly available through digital and online channels. Uptake of digital and online banking has been substantial over recent years.

Cash withdrawals are additionally available through many retail outlets indicating an overall high degree of access to banking services for individual and business customers in Australia. This is confirmed in the analysis by Bain and Company that shows Australians have readily adopted self-service digital channels.

Figure 1.20: Bank branches per 100,000 adults

	2004	2014	2015
Australia	30.7	29.2	28.7
United Kingdom	29.0	-	-
United States	32.5	32.2	32.9
Canada	-	23.9	23.6
China	-	8.0	8.5
Germany	21.3	14.5	14.1
Japan	34.6	33.9	34.1

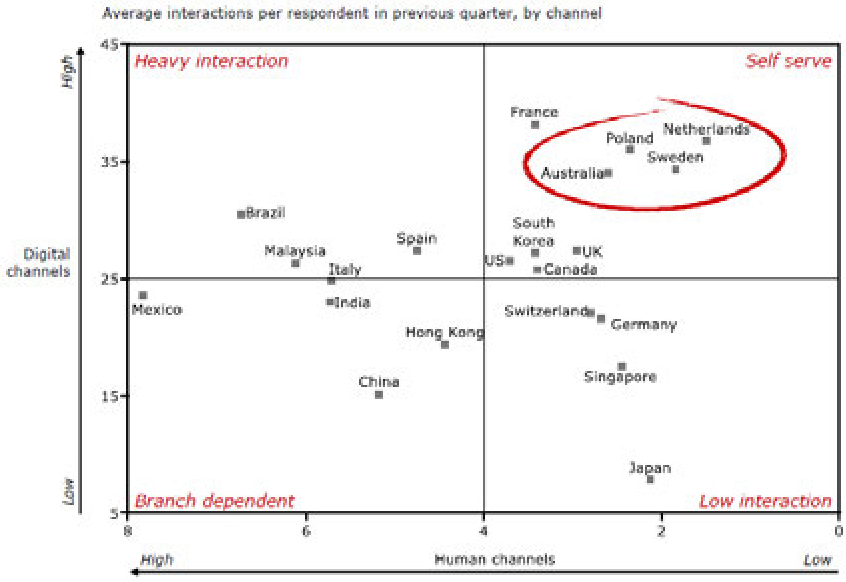
Source: World Bank

Figure 1.21: ATMs per 100,000 adults (all providers)

	2004	2014	2015
Australia	133.8	160.1	164.6
United Kingdom	117.7*	129.8	131.6
United States	164.8	..	..
Canada	184.8	221.1	220.5
China	..	54.4	76.4
Germany	..	123.1	121.1
Japan	124.3	127.5	127.6

Source: World Bank, *2005 data

Figure 1.22: Access to banking services by channel

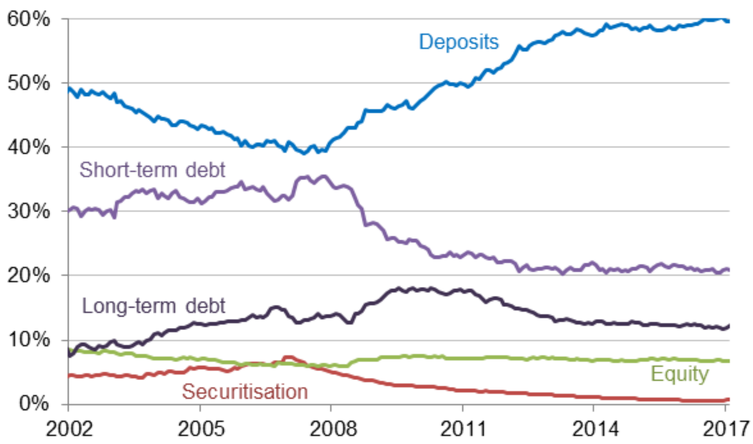


Source: Bain & Co/Research Now Retail Banking NPS Survey, 2016. Note: Digital channels exclude ATM

1.4 Bank funding costs

Banks have a diversified range of sources of funding. Since the GFC there has been a marked increase in reliance on individual and business deposits as banks have sought to reduce their reliance on international funding markets, which can be unreliable in times of financial disruption. Banks have also reduced their reliance on the securitisation markets which experienced liquidity problems during the GFC.

Figure 1.23: Composition of bank funding

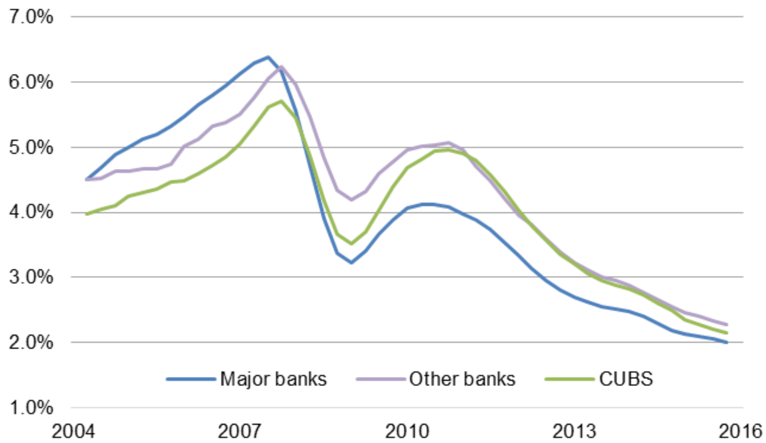


Source: RBA

Only a small portion of these funding sources have interest rates linked directly to the RBA cash rate, which is the interest rate charged by the RBA on overnight money lent to banks. Most bank funding is longer-term. Therefore, the overall average cost of funds changes only slowly in response to RBA cash rate changes. This is increasingly the case with regulatory interventions encouraging banks to diversify into, longer-term and more secure funding sources.

There are differences in the funding costs of different banks. An estimate of average funding costs can be calculated by comparing the interest expense for key funding liabilities (deposits, short and long-term borrowings) and dividing this by the outstanding liabilities for these funding categories. This measure shows that the cost advantage of the major banks changes over time in response to the economic cycle and the level of interest rates. Major banks' funding costs have been about 30 bps lower than for other domestic banks, but only 20 bps lower than credit unions and building societies over the past year.

Figure 1.24: Funding costs by type of ADI



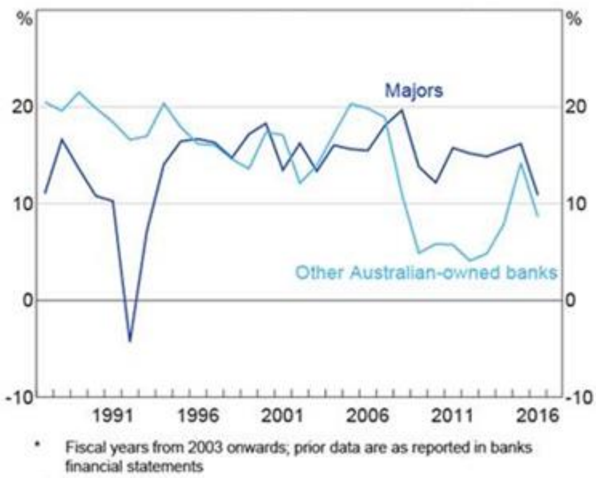
Source: APRA

1.5 Profitability and efficiency of Australia's banks

Australia's banks are profitable. Return on equity (**ROE**) of Australia's major banks is solid although has eased from since the GFC. In recent years the profitability of the major banks has been higher than other banks, although the gap has closed.

Major bank profitability is not unusually high relative to overseas markets, being around the same level as in Canada, which has a similar banking industry structure and similarly did not experience substantive bank failures during the GFC. Profitability of banks is lower in countries which experienced a higher impact from the GFC, such as the USA and many countries in Europe.

Figure 1.25: Banks' RoE



Sources: APRA, banks' annual reports, RBA

Figure 1.26: Banks' RoE by jurisdiction (2016)

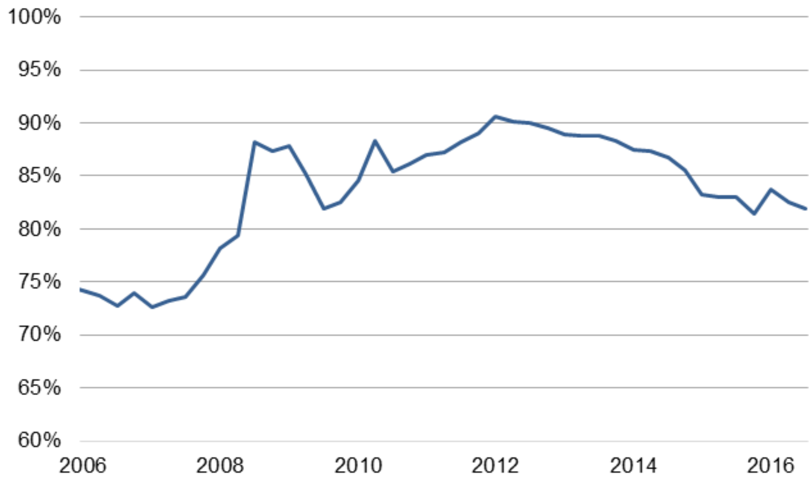
	Number of banks	RoE
Venezuela	6	45.9%
Indonesia	3	17.6%
Saudi Arabia	2	16.5%
Brazil	5	15.7%
Canada	5	14.9%
China	8	14.4%
Australia	4	13.4%
Sweden	4	11.8%
Hong Kong	2	11.4%
India	5	11.3%
Singapore	3	9.8%
USA	6	9.5%
South Korea	2	8.0%
Spain	3	6.5%
France	4	6.0%
Japan	4	5.8%
UK	5	-0.1%
Italy	2	-9.9%

Source: Thomson-Reuters

Developments in the share of profits of the different classes of banks mirror developments in the structure of the financial system.

The major bank's share of ADIs' after-tax profits increased sharply after the onset of the GFC from around 75 per cent to a peak of 90 per cent over the last half of 2012. However, since mid-2012 the share of the major banks has been falling, although it remains high at just over 80 per cent.

Figure 1.27: Major banks' share of ADI profits



Source: APRA

1.5.1 Where do profits go?

About 30 per cent of banks' taxable income is paid in income tax to the Federal Government with $12.8 billion in tax being paid by Australian banks in 2016.

Around 75 per cent of banks' post-tax profits are paid out in dividends to shareholders with $25.6 billion being paid in 2016. About three quarters of the major banks' shares are owned by domestic shareholders. Almost every Australian owns shares in an Australian bank, or most likely several, through their superannuation or directly through their shareholdings. In fact, some of the largest shareholders in Australian banks are superannuation funds, including industry funds, retail funds and self-managed superannuation funds.

The remaining 25 per cent is retained to reinvest into the business. Investment in banking is critical to ensure banking systems, security protections and technology functionality for 24/7 service is continuously improved for the benefit of individual and business customers.

Another indicator of the underlying profitability of banks is the net interest margin (**NIM**), i.e. the difference between interest earned and interest paid, as a share of interest-earning assets.

The NIM of Australia's largest banks is 'middle of the road' relative to other key countries and again is about the same as in Canada. The NIM that we have used here is the whole of bank NIM, which will be affected by parts of the banks other than the retail business.

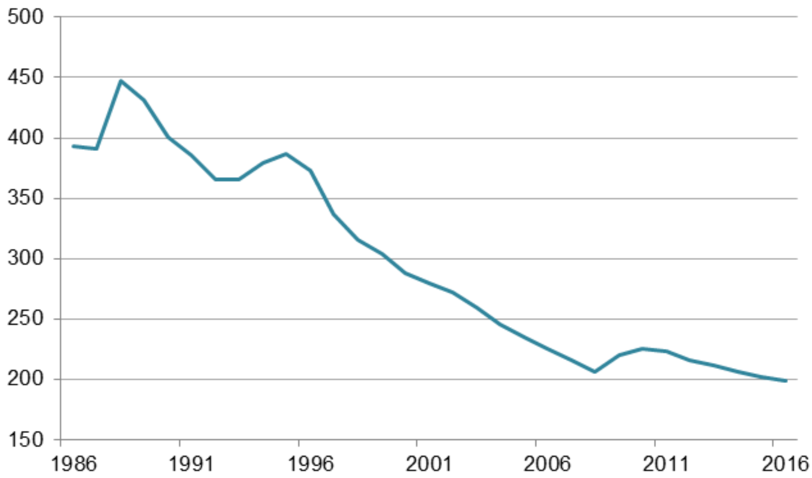
Figure 1.28: Net interest margin by jurisdiction (%)

	2005	2014	2015
Australia	3.46	2.01	1.65
United Kingdom	1.22	2.56	1.39
United States	3.48	2.98	3.19
Canada	1.59	1.76	1.59
Germany	0.91	1.07	1.09
Netherlands	0.90	2.05	1.54
Sweden	0.88	1.26	1.10
Norway	1.69	1.55	1.44
China	2.64	3.65	2.75
Japan	1.23	0.91	0.98

Source: Word Bank

The NIM has fallen markedly over recent decades. Banks' NIM fell between the early 1990s and the mid- 2000s. The NIM for the industry has been little changed over the past decade.

Figure 1.29: Net interest margin (basis points)



Source: Australian Treasury

Australia's banks are also highly efficient, with a cost-to-income ratio lower than in many other developed economies. This benefits Australian customers through more competitive pricing and shareholders through dividend payments as well as the taxpayer, and government through higher company tax payments. This is also evidenced in international comparisons of return on assets.

Figure 1.30: Bank cost-to-income ratio (%)

	2005	2014	2015
Australia	58.5	64.9	62.5
United Kingdom	58.5	116.7	118.1
United States	57.9	74.7	72.5
Canada	59.5	90.2	92.6
Germany	63.5	133.8	128.5
Netherlands	63.4	85.2	81.0
Sweden	66.5	81.3	83.5
Norway	56.5	56.7	52.3
China	41.1	48.7	49.0
Japan	52.4	83.2	86.2

Source: Word Bank

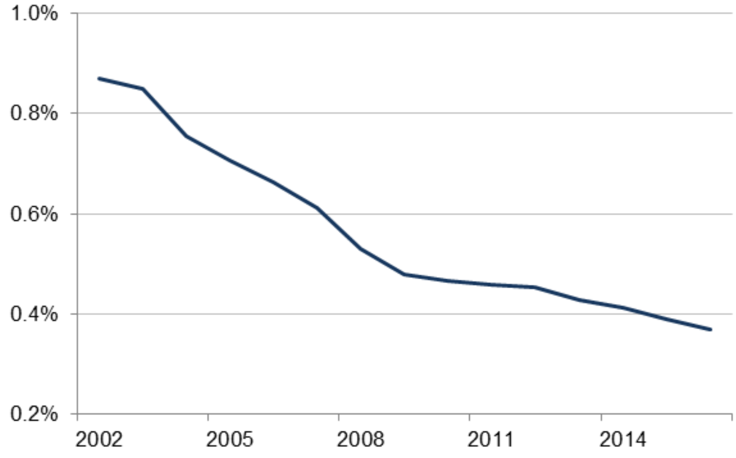
One measure of the benefits to customers of the increasing efficiency of banks is the ratio of fees charged relative to business activity. The latest study of bank service fees[6] (fees earned in the process of taking deposits, making loans and providing payment services) shows:

- The ratio of bank service fees to assets and operating income has now fallen to record lows.
- Mortgage fees relative to home loans are the lowest on record.
- Credit card fees relative to credit accessed remain near the lowest level in ten years.

[6] Fees for banking services, 2017 report, Australian Bankers Association

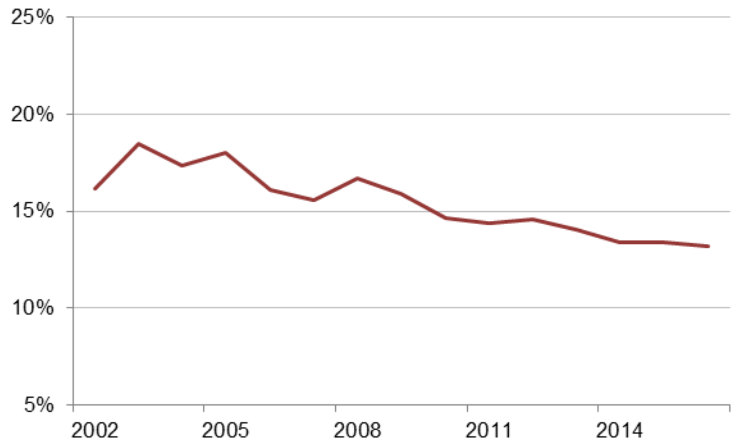
- The average cost to consumers of transaction banking continues to fall rapidly.
- The ratio of fees from business loans to total business loan outstandings has fallen over the past four years.

Figure 1.31: Ratio of bank service fees to resident assets



Source: RBA

Figure 1.32: Ratio of bank service fees to operating income



Source: Banks' annual reports

1.6 Bank investment

Financial innovation is at the core of delivering higher productivity and a higher standard of living for Australians.

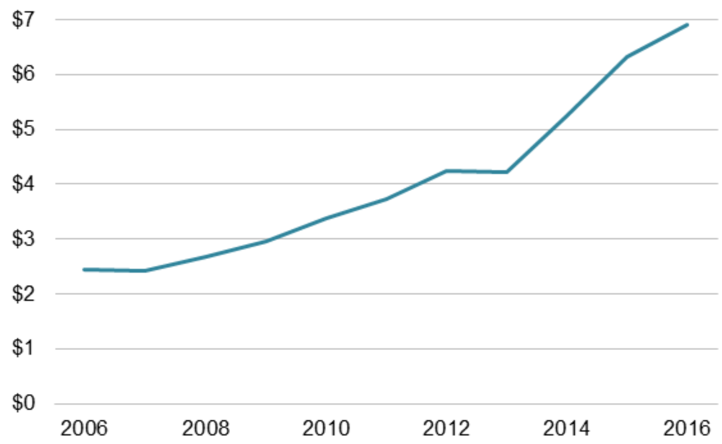
There are many players in financial innovation, but banks are still the main drivers.

Banks are big innovators – they lower costs, open new business opportunities and deliver higher customer experience and satisfaction.

Banks' technology spend has seen a significant rise over the past decade, in particular, with strong growth over the past two years:

- Over 2016, technology spending by banks was $6.9 billion compared with $2.4 billion ten years ago (2006) - rising from 7.7 per cent of banks operating expenses in 2006 to a high of 14.9 per cent in 2016.
- The finance and insurance industry ranks third on a net basis after information and telecommunications, and then electricity, gas and water for size of net capital stock.
- Gross fixed capital formation which relates to computer software is highest for the finance and insurance industry - this has been the case for the past 14 years.

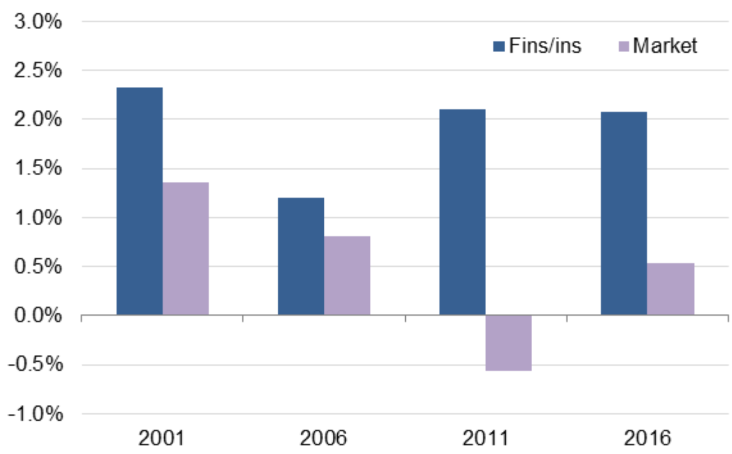
Figure 1.33: Banks IT spend ($bn)



Source: Banks' annual reports

This strong technology spend helps drive high growth in productivity. Over the three years ending June 2016, productivity of the finance and insurance industry has been on average 2.6 per cent per year, nearly four times higher than the overall market sector (on average, 0.7 per cent per year).

Figure 1.34: Multifactor productivity (five year average)



Source: ABS

2. Competition and customer outcomes

The competitive nature of Australia's banking industry drives banks to invest in new products and services, providing customers' with choice, convenience and access. It also places a discipline on banks to serve their customers well and to drive better customer outcomes. This chapter explores developments that affect customer choice and consumer protections, and how they could enhance the competitive environment.

2.1 Innovation and improving the customer experience

Banks in Australia are leaders in technological innovation which lifts productivity and growth across the economy and ensures the financial system meets customers' evolving needs. This investment takes place owing to the competitive environment and the need for banks to continually compete for customers.

There are regular examples of banks fostering innovation through in-house developed offerings as well as through partnerships with new market participants. This innovation has emerged within a stable and well-regulated financial system which contributes to a positive customer experience which has not undermined consumer protections.

The ABA believes all innovation initiatives must place customers' needs and protection at the forefront.

Regulatory authorities have displayed varying levels of interest in innovation. The ABA commends ASIC in particular for its forward looking approach to financial services regulation articulated through its Innovation Hub and recent Report 523*: ASIC's Innovation Hub and our approach to regulatory technology*. In particular, we welcome ASIC's commitment to "provide the right balance between innovation and the risk of the poor consumer and market integrity outcomes".

The ABA also agrees with ASIC that:

> *"… it is very important that technological change, regardless of the opportunities it creates, does not inadvertently reduce the standard of service provision and trust and confidence in the financial services sector."*

The ABA believes that there would be benefit to greater innovation policy coordination between relevant regulators including APRA, AUSTRAC, and ASIC, together with Treasury, the RBA and the Government's Fintech Advisory Group that would enhance innovation reform within banking.

ABA position

The ABA supports a whole-of-government approach to innovation policy with strong industry engagement across institution type to ensure sound and innovative policy settings are encouraged, and to facilitate collaboration between existing institutions, firms and new entrants.

2.1.1 Open banking

Open data across the Australian economy will have profound impacts on the way consumers can access data about themselves across providers and industries. These developments are well canvassed in the PC's final report into Data Availability and Use.

The ABA supports the approach outlined by the PC. The proposed Consumer Right is a good piece of the economy-wide solution to enable data sharing. The ABA strongly believes that open banking should be introduced against the backdrop of a sound regulatory framework that addresses consumer protections such as privacy and liability when something goes wrong, and data security. Once these regulations are in place, industry should work on implementing its own technological solutions appropriate to the consumer needs and circumstances.

The ABA's members are working within the tight timeframes of the Government's 'Farrell Inquiry' to articulate a path forward to a successful open banking regime. The ABA would note that the success of open banking will depend on the correct sequencing of reforms and suitable time periods to devise appropriate solutions once consumer use cases have been determined.

ABA recommendation

The ABA believes the full benefits of open data, including greater competition for customers will rely upon a sound regulatory foundation that addresses privacy and liability concerns. Industry should also be given the opportunity to develop the security and data standards. The ABA's members are devising a path forward for open banking as part of the ABA's response to the Farrell Inquiry.

2.1.2 New Payments Platform

Another area where the ABA's members are demonstrating commitment to innovation is the New Payments Platform (**NPP**) which is a $1 billion investment by financial institutions in a payments infrastructure that will modernise payments in Australia.

Key features of the NPP are:

- The NPP is a new national open access payment platform which is separate from the existing payment streams.
- The first service using the NPP infrastructure will be the real time settlement of retail payments. Payments will be able to be made and received in a matter of seconds, 24 hours a day, 365 days of the year.
- The first service, or defined customer experience, to be a launched using this new infrastructure will offer peer-to-peer real time payments between individuals, and it has been branded Osko.
- Osko, by BPAY, will leverage a key capability of the platform – PayID – which enables users to direct payments to identifiers that are easier to remember than a BSB or Account Number.
- An Addressing Service will enable transaction accounts to be identified by a 'smart' payment address such as an email address, phone number or Australian Business Number. This 'proxy identifier' will allow other people to make payments to them without having to use a BSB and account number.
- This identifier can be moved between accounts or financial institutions through a relatively simple process.
- The industry is currently in the middle of rigorous testing and the platform is on track to become available later this year. From there, various players will commence rolling out services from the end of the year and into 2018.
- Looking ahead, banks and other players in the payments system are exploring the new services they can offer customers to improve their lives using the rich functionality of NPP.

ABA position

The ABA believes the NPP is an excellent demonstration of how industry collaborating together with regulators can lead to positive customer outcomes.

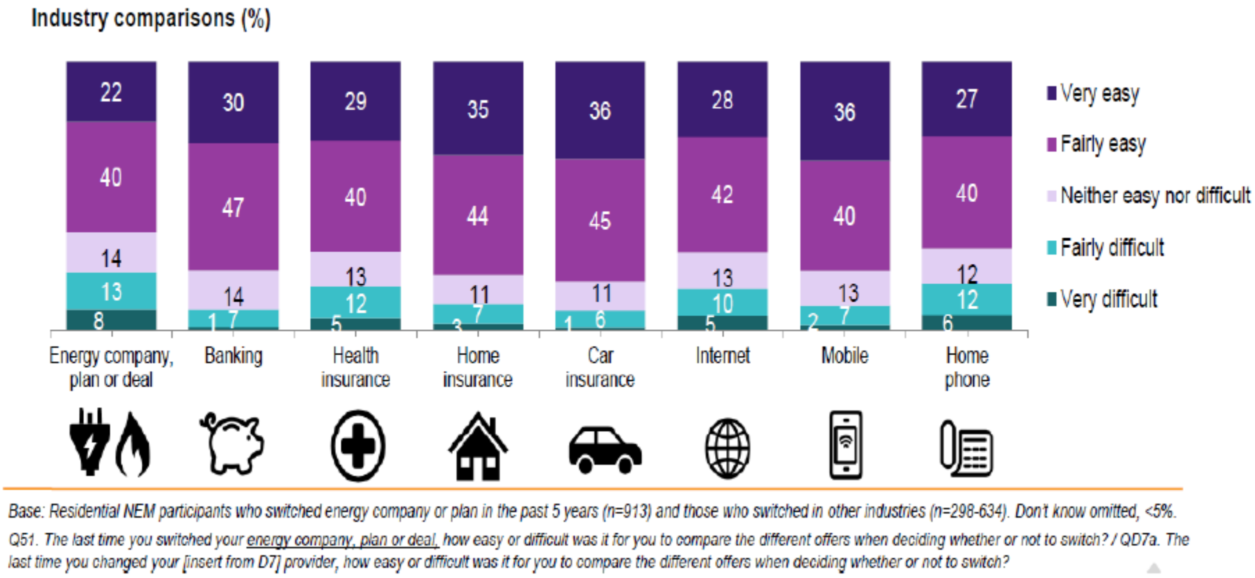
2.2 Bank switching

The ability to easily and cheaply switch between financial institutions is key to consumers accessing the benefits of competition in the banking and financial services industry.

Successive Australian governments have undertaken reforms to reduce impediments to switching in financial services and substantial progress has been made. Nevertheless, a perception remains that switching is difficult and this stops customers from moving their banking relationship.

A study by Newgate Research on behalf of the Australian Energy Market Commission in July 2017 found that consumers found switching providers in banking relatively easy. Around three-quarters of consumers who had switched banks in the past five years had found it "very easy" or "fairly easy" and this was only behind car insurance in terms of ease of switching.[7]

Figure 2: Industry comparisons of ease of customer switching



Source: AEMC

The ABA commissioned its own survey by Galaxy Research in February 2017 on bank switching which found:

- One in six people (17 per cent) had switched banks over the last three years while 83 per cent had not.
- Of those who had switched banks over the last three years, two-thirds (68 per cent) found that switching was an easy process while 21 per cent said that they had found it difficult.
- Those who found switching difficult made up just 4 per cent of the overall population of customers.
- There was a larger, but still small, (7 per cent) proportion of customers who had not switched because they either *felt* that it was too difficult or may have *tried* to switch but found it too difficult to do so.
- Of those customers who experienced difficulty with switching banks, or thought it would be difficult, a bit more than half felt that this was because changing automatic payments and direct debits was too much hassle, and that the process of switching banks was too complicated or that it would take too much time and effort.

[7] Australian Energy Market Commission, (25 July 2017), *2017 AEMC Retail Energy Competition Review: Final Report* http://www.aemc.gov.au/Markets-Reviews-Advice/2017-Retail-Energy-Competition-Review

- More than half (58 per cent) of those who did not switch banks said that they were comfortable with their own bank.
- Almost two-thirds of customers (62 per cent) have accounts at more than one bank. This suggests that they have ‘switched’ banks for certain bank products and services. The proportion of people with accounts at more than one bank increases with age, with educational attainment and with home ownership.
- The perception that switching is difficult is highest for mortgages and personal and car loans, significantly lower for credit cards and lowest for everyday bank accounts. However, given the larger number of transaction accounts and credit cards, issues with these categories tend to dominate consumers’ concerns.

A range of other data confirms that switching banking relationships is not uncommon.

Mortgage refinancing – where a customer refinances a mortgage by changing the mortgage provider – has been broadly running at around one-third of all housing loan commitments for the past decade. Over the year ending June 2017, there were 219,284 refinances of home loans, representing just over 30 per cent of new housing loan commitments. Having said that, it is interesting that there has not been a sustained and significant uplift in mortgage refinancings since the reforms of 2012 (more on this below).

Historically, a refinancing transaction could typically take more than one month to process. With the introduction of electronic conveyancing for processing mortgage transactions, particularly refinancing transactions between ADIs, the time taken for a mortgage to move to another ADI or lender can be significantly reduced.

National electronic conveyancing was mandated in a 2010 decision by the Council of Australian Governments to deliver a national electronic conveyancing solution to transition from a paper-based settlement system to a fully digital system.

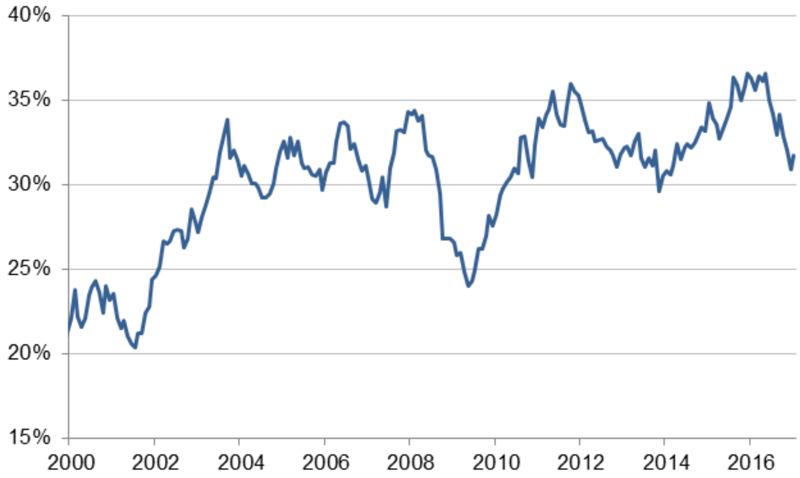
This was achieved in collaboration with the ABA, Law Council, Australian Institute of Conveyancers and the four major banks from which evolved Property Exchange Australia (**PEXA**) through the use of PEXA’s digital platform for completing online lodgement and property settlements.

It means conveyancers, lawyers, banks and land registries interact, collaborate and share information. It removes the need for bank cheques, postal services and attending settlement in person. PEXA integrates into state-based land registries' databases.

Settlement times through PEXA have almost halved, dropping on average from 40 days to 20 days. This is important if a customer’s refinancing is urgent.

From 1 August 2017 Victoria’s and New South Wales’ land registries are requiring all (subject to some specific exceptions) refinancing transactions involving land mortgages between ADIs to be lodged electronically. Western Australia will require this from 1 December 2017 with South Australia expected to do the same early in 2018.

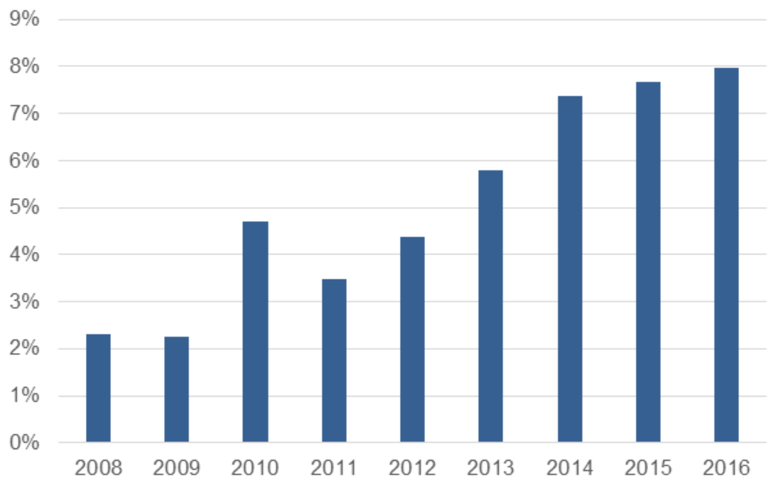
Figure 2.1: Owner-occupier mortgage refinancing (%)



Source: ABS

Credit card balance transfers – where a customer transfers from one credit card provider to another – provide a measure of the ability to switch credit cards. These demonstrate that banks have processes in place to switch credit cards relatively easily. In 2016, 8 per cent of credit card balances were a balance transfer[8], the highest level in the nine year data series.

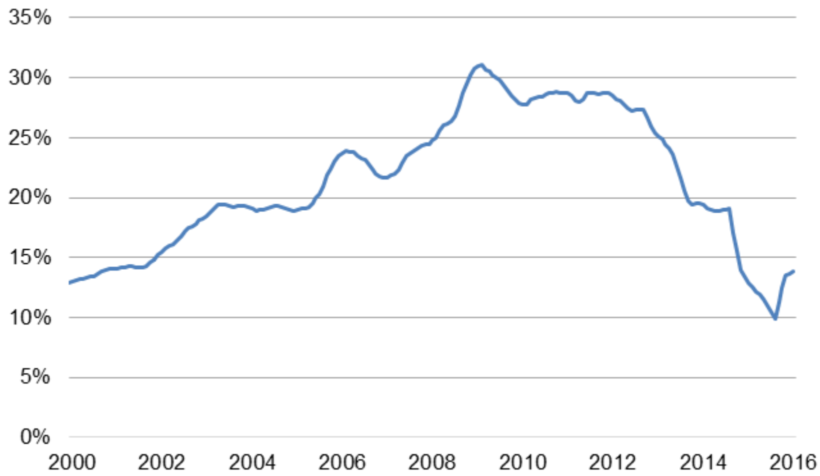
Figure 2.2: Balance transfers as a proportion of credit card balances



Source: Argus

[8] Argus

Figure 2.3: Personal loan refinancing



Source: ABS

Data on switching of transaction accounts is dated, but data from APN and Choice cited in the 2011 Treasury paper on switching, pointed to switching rates of around 8-10 per cent of transaction accounts per annum. This was assessed as being comparable with estimates of switching rates in some European countries which had more formal switching mechanisms.

2.2.1 Barriers to switching

While the data suggests there is a not a widespread issue with switching, issues remain around payments that are linked to bank accounts.

Switching banking relationships requires a customer to:

- Close accounts with the old bank. This may involve a visit to a branch although some institutions offer online or over the phone services.
- Cancel regular/scheduled payments in and out of those accounts. For transaction accounts these can include direct credits (such salary payment into an account) and direct debits (payments to service providers from an account) and periodical payments (such as payments to other accounts to ensure the outstanding balance is always paid on time like credit card balances). For cards this can include recurring payments to merchants. There can also be regular/scheduled payments linked to other types of accounts such as mortgages.
- Open a new account with a new bank. Legislation requires identity to be proved and verified. Credit standing will need to be established for lending products. Many institutions offer facilities for opening some accounts online, e.g. some credit card accounts and deposit accounts. There are now some institutions which offer only online services, including the account opening and electronic verification. In general opening new accounts is relatively straightforward.
- Reinstating regular/scheduled payments with the new account.

The key issues relate to cancelling direct debits or recurring payments.

A direct debit is defined as an amount debited to a specified transaction account of a customer as authorised by the customer, which is processed through the Bulk Electronic Clearing System (**BECS**).

A recurring payment is a regular payment made using a credit card or a debit card and is processed through the card scheme (Visa, Mastercard, Amex, Diners). Merchants can process and flag payments in a number of ways, so there is less consistency than for direct debits.

For open accounts, the Code of Banking Practice obliges a bank to cancel a direct debit request. However, this obligation does not apply to a payment service relating to a credit card account. Specifically, the Code of Banking Practice provides that:

- Clause 21.1: We will take and promptly process your (a) instruction to cancel a direct debit request relevant to a banking service we provide to you.
- Clause 21.3: Clause 21.1 does not apply to a payment service relating to a credit card account.

Credit cards and debit cards are covered by card scheme rules. At present the only way to change these payments from one card to another is for the customer to contact each service provider to cancel the existing payment and to arrange a new recurring payment to the new card. This has been identified by the government[9] as an impediment to switching:

> *"These inertia effects appear to be compounded by the time and effort required to cancel an existing card account. Consumers wishing to cancel an existing card are generally required to do so by visiting a bank branch or by calling a consumer service representative. During this process they may be encouraged to keep their card open, sometimes through attractive offers. The time and effort involved in transferring recurring payments from a consumer's existing card to a new card can also make some consumers reluctant to switch."*

2.2.2 Industry reforms to make switching easier

The ABA is working on a number of reforms to facilitate easier switching. These reforms include incorporating a number of additional obligations into the new Code of Banking Practice as well as working with the card schemes to identify potential solutions to enable banks to carry out customer requests to cancel recurring payment transactions on credit cards.

The following provides an outline of these pending changes.

Accounts to be closed when requested without delay – including card scheme accounts

Banks will ensure accounts can be closed as soon as possible when a request is received. Some accounts will take longer to close, for example, term deposit accounts which are not yet at the maturity date or require a minimum of 30 days notification, and home loan accounts where debt has to be repaid and mortgage documents released.

For loan accounts closure this will be subject to the prior repayment of outstanding debts and interest charges, and payments which had been pre-authorised but not yet received, for example hotel bills.

Card scheme accounts include credit and debit cards. There are operational complexities associated with cancelling a credit or debit card (i.e. recurring payments, outstanding payments and outstanding balance) that may require direct communication with a customer to resolve.

Additionally, banks may initiate a 'closure interview' to understand the reasons for an account closure. Often it is an issue of a change in customer needs and the customer now having a wrong product, and the offer of an alternative product can better suit customer circumstances.

Where not already current practice, banks commit to amend account closing protocols to permit customers to 'opt out' of or end the closure interview. The mechanism for closure will need to be a matter for individual banks.

[9] Australian Government, (May 2016), "Credit cards: improving consumer outcomes and enhancing competition", p9

An assurance that direct debits/recurring payments will not be honoured and will be returned to the originating merchant once the account had been closed

There are mechanisms available to ensure recurring payments are not posted to closed accounts.

For card scheme accounts this can involve appropriate flagging of the account, appropriate flagging of merchant payment requests so that they are not posted, or adoption of technical solutions through the card schemes.

Importantly, customers will need to be clearly informed that closing the account will not cancel the contractual arrangement between the customer and the merchant and the debt will continue to accrue. Outstanding payments will be an issue between the customer and the merchant, rather than an issue for the issuing bank.

Banks will work with the card schemes on determining the system build, cost, and time required to implement this solution.

Banks to provide a list of all recurring payments on all accounts to the customer on request, within an agreed timeframe

Issuing banks can provide a list of direct debits on transaction accounts. However, it is not currently possible for issuing banks to reliably identify recurring payments for card scheme accounts. These payments can be identified if they have been appropriately flagged by the merchant, but this is not always the case. Issuing banks may still be able to identify recurring payments through manual scrutiny although this can be complicated if amounts change, for example for a utility bill.

Banks are working with stakeholders, including the card schemes, to identify solutions to reliably identify recurring payments on card scheme accounts.

A guarantee to act on the instructions of customers to cancel recurring payments on all accounts, including card schemes where the account remains open

Banks will work with the card schemes on determining the system build, cost, and time required to implement a solution that enables banks to carry out customer requests to cancel card recurring payment arrangements.

The provision of clearer and more accessible information on how to close accounts, and how to switch accounts to new providers, on websites and in branches

The ABA agrees that customers should understand how to close an account and clear information should be readily available.

All banks already provide information about how to close accounts, but will endeavour to better understand the core concerns of customers and ensure this is adequately addressed in the information made available across channels, such as on websites, through branches and in other fora to improve clarity and transparency.

Reduce turnaround time for the APN switching service from five days to three days

The APN is putting in place measures to reduce the turnaround time to three days for the switching facility under which a new financial institution will do the work of switching regular direct debits and credits from the old account.

ABA position

The ABA is incorporating a number of reforms into the new Code of Banking Practice as well as separately working on reforms to facilitate easier bank switching. These new code obligations include:

- Accounts to be closed when requested without delay.
- Banks to provide a list of recurring payments on all accounts to the customer on request.

- The provision of clearer and more accessible information on how to close accounts, across channels, such as online and in branches.

These new obligations complement the existing code obligation on banks to promptly process cancellations for direct debits on banking services (noting that compliance and process matters have been raised in the past).

The ABA is also working with card schemes to identify potential solutions to enable banks to carry out customer requests to cancel recurring payment transactions on credit cards. Banks will work with card schemes on the system build, cost and time required to implement this solution.

In addition, the APN is putting in place measures to reduce the turnaround time to three days for the switching facility under which a new financial institution will do the work of switching regular direct debits and credits from the old account.

2.3 Product design and distribution

FSI recommendations 21 and 22 proposed strengthening product issuer and distributor accountability through the introduction of a principles-based product design and distribution obligation, and product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

The Government responded to these recommendations by agreeing to create a targeted and principles-based financial product design and distribution obligation, and providing ASIC with a financial product intervention power to enable it to modify, or if necessary, ban harmful financial products where there is a risk of significant consumer detriment. The ABA is pleased to see the Government's consultation on these measures and looks forward to working with Government on the exposure draft legislation.

The ABA supports the introduction of a principles-based, flexible, and scalable product design and distribution obligation, and supports in principle a targeted product intervention power to stop the distribution of products where there is a risk of significant detriment or harm to consumers.

The ABA believes that the new design and distribution obligation should not extend to introducing default products or prohibiting distribution of certain classes of products to consumers. This would have significant adverse impacts on the offer and sale of financial products by reducing innovation and restricting consumer choice.

Importantly, product design is a commercial decision and regulatory intervention to standardise or prescribe certain product features can create other problems for competitive product offerings by increasing product costs or decreasing product offerings for consumers.

ABA position

The ABA supports the work underway by Treasury to introduce a product design and distribution obligation, and a targeted product intervention power. The ABA will continue to liaise with Treasury on the legislation.

2.4 Financial advice

2.4.1 FOFA reforms and professionalisation

The FOFA reforms introduced a 'best interests' duty for financial advisers providing personal advice on complex financial products.10 The duty requires the financial adviser to conduct a reasonable investigation into the financial products that might achieve the client's objectives.[11]

[10] s961B *Corporations Act 2001* (Cth)
[11] s961B(2)(e) *Corporations Act 2001* (Cth)

ASIC has also issued guidance on the requirements for financial advisers giving personal advice on super switching[12], specifying that advice will generally be inappropriate (and therefore in breach of the Corporations Act[13]) if the adviser knew (or should have known) that the overall benefits likely to result from the 'to' fund would be lower than under the 'from' fund, unless outweighed by overall cost savings; and the cost of the 'to' fund is higher than the 'from' fund, unless the 'to' fund better satisfies the client's needs.

The Government has established the new professional standards body FASEA – to set new education, ethical and professional standards for financial advisers. The new professional standards framework covers:

- Minimum qualifications
- Entry exam
- Continuing professional development
- Supervision year for new advisers, and
- Code of ethics.

The ABA supports in principle the training requirements contained in *Regulatory Guide 146: Licensing: Training of financial product advisers* [RG 146] being transferred to the FASEA once the new professional standards framework for financial advisers is in place. This would streamline administration of standards and compliance for AFS licensees by ensuring training and education requirements and ongoing professional conduct is not shared by FASEA and ASIC.

These requirements, together with other conduct obligations under the Corporations Act and the new professional standards framework, require an investigation of products available in the market by financial advisers meeting higher education, ethical and professional standards, and place a high bar on product replacement or switching advice. These obligations promote clients being given recommendations for the products that best suit their objectives, financial situation and needs from across the market.

ABA position

The ABA believes the Future of Financial Advice (**FOFA**) reforms for financial advisers, coupled with the new professional standards framework for financial advisers and ASIC's regulatory guidance on the offer of complex products, provide protection for consumers to ensure they receive financial advice in their best interests. Once the new professional standards framework for financial advisers commences and the new standards are set, the ABA's members support the Financial Adviser Standards and Ethics Authority (**FASEA**) administering the training requirements for other financial services professionals.

2.4.2 Definition of financial product

The definition of "financial product advice" in section 766B of the Corporations Act refers to recommendations or statements of opinion that are intended, or could reasonably be regarded as intended, to influence a person or persons in making a decision in relation to a particular financial product or class of financial products. The definition distinguishes between 'personal advice', where the client's individual circumstances are taken into account, and 'general advice' where they are not.

The current definition of financial product advice has two key practical problems, which act as a barrier to improving the accessibility of advice to consumers, restricts innovation and arguably inhibits competition.

Firstly, the distinction between personal and general advice is impractical. Consumers generally interpret 'advice' as advice that takes into account their individual needs and circumstances and do not generally appreciate the significant legal and technical differences between 'general' and 'personal'

[12] *Super switching advice - complying with your obligations - INFO 182* http://asic.gov.au/regulatory-resources/superannuation-funds/superannuation-advice/super-switching-advice-complying-with-your-obligations-info-182/
[13] s961G, *Corporations Act 2001* (*Cth*)

advice. Maintaining this artificial distinction requires significant investment in compliance and oversight processes that add costs for consumers, reduce accessibility and restrict innovation.

Secondly, the definition does not include, and therefore regulate, advice on investment strategies and other significant financial matters such as aged care payment advice and for-profit financial difficulties and budget management services. As a result, these providers operate with lower barriers to entry and compliance requirements, and consumers using their services do not benefit from consistent consumer protections.

The ABA supports a review of the scope and label for 'financial product advice' that clarifies or removes the concept of general advice and brings into scope other types of advice on significant financial matters. This review should focus on clarifying the service provided to a consumer, increasing accessibility and innovation in advice, and promoting competition by ensuring equal barriers to entry and compliance requirements.

ABA position

The ABA believes the definition of financial product advice should be reviewed. We support the clarification of the term 'general advice', however, consider that a more fulsome consideration of financial advice is needed to ensure the law keeps up with consumer expectations about what and how they receive advice.

2.5 Product disclosure

FSI recommendation 23 proposed removing regulatory impediments to innovative product disclosure and communication with consumers, and improving the way risks and fees are communicated to consumers. The ABA supports the ongoing efforts by ASIC and the industry to promote innovative product disclosure. We also encourage the Treasury to prioritise introduction of legislation to facilitate disclosure through interactive methods.

ABA position

The ABA supports more innovative disclosure, including removing regulatory barriers to better utilising technology and digital disclosure that will see the costs of producing (and printing) disclosure documents reduce, while making them clearer and easier to navigate, and therefore more likely to be understood by consumers. The ABA's members await further consultation on FSI recommendation 23 and support work by Treasury being prioritised on this area.

2.6 Business models (including vertical integration and full service banking)

2.6.1 Vertical integration

Ongoing public attention and media commentary has focused on the concept of vertical integration and the impact these structures have on customer outcomes, including the impact of perceived and actual conflicts of interest.

The term "vertically integrated" has come to mean a business operating model where legally related companies run financial services businesses across the financial services value chain. This is an example of vertical integration, however, some form of vertical integration is common across the banking and financial services industry and can include:

- Superannuation funds operating in-house investment management functions
- Product issuers providing financial advice, including intra-fund advice, on products they manufacture, and
- Product issuers having commercial partnerships with financial advice businesses, administration services and other commercial relationships.

2.6.2 Full service banking

Many banking groups offer an integrated and full service banking model, that include individual and business banking, mortgages, investment, superannuation and insurance.

For consumers, full service banking offers a value proposition of investment, innovation, specialisation and capital strength. A relationship with a bank, across the financial services value chain can allow the bank to develop a better understanding of the objectives, financial situation and needs of their client, and therefore provide better quality financial advice and, where reasonable and appropriate, better targeted product solutions. Consumers can also access different types of advice suitable to their needs and circumstances across different channels, including face-to-face, verbally, online and more innovative advisory solutions.

Many customers take advantage of simplifying their financial arrangements and reducing their costs by having their products with one bank. Meeting all or many of a customer's banking needs has a clear service imperative. What's important is that banks provide good service, suitable products and quality advice to their customers.

2.6.3 Managing conflicts of interest

Like other financial services providers and credit providers, banks are subject to a well-developed set of conflicts management obligations. These include Corporations Act conflicts management requirements and additional obligations for product issuers where they are a superannuation or master trust trustee (Superannuation Industry (Supervision) Act and general law obligations).

To comply with the law, financial advice businesses with related party conflicts must have in place adequate arrangements to manage conflicts of interest so that the quality of the financial services is not significantly compromised.

2.6.4 Disclosure

As part of managing perceived conflicts of interest, the ABA believes it is important for ownership structures to be clearly and fully disclosed. FSI recommendation 40 proposed requirements for financial advisers and mortgage brokers to disclose ownership structures. Requirements for disclosure of ownership structures in mortgage broking are set out in Proposal 4 of the ASIC Review of Mortgage Broker Remuneration.[14]

ABA position

The ABA supports reforms to improve remuneration structures, governance practices and transparency in banking and financial services. Banks are actively working with lenders, aggregators and brokers to develop an industry response for improving remuneration structures, governance practices and disclosure of ownership structures in mortgage broking.

2.7 Remuneration to support good customer outcomes

In April 2017, Mr Stephen Sedgwick AO completed an independent review of product sales commissions and product based payments in retail banking (Sedgwick Review).[15] The Sedgwick Review covered retail bank staff and third parties who receive payments for selling banking products, such as deposit accounts, mortgages and credit cards. The aim of the Sedgwick Review was to assess whether and how product sales commissions and product-based payments in retail banking could lead to poor customer outcomes.

The Sedgwick Review made recommendations in relation to the remuneration structures of customer-facing staff and their supervisors and managers, governance and performance management systems that apply across the bank, and payments to third parties, including mortgage brokers.

[14] http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-516-review-of-mortgage-broker-remuneration/
[15] http://retailbankingremreview.com.au/

ABA position

The banking industry has committed to implementing the recommendations of the 'Sedgwick Review', covering changes to remuneration and incentives for bank employees, governance and performance management systems, and payments to third parties, including mortgage brokers.

2.8 Strengthening consumer protections

2.8.1 Better banking

In April 2016, the ABA launched the Banking Reform Program, a package of measures designed to ensure that Australia's banks meet the expectations of their customers and the community.[16] The Banking Reform Program is a fundamental change in the way banks do their business. The initiatives will transform the culture and conduct of our banks to the benefit of customers.

Significant progress has been made in implementing the industry reforms, including the introduction of dedicated customer advocates, improvements to protection for whistleblowers to encourage a 'speak up' culture and improvements to customer remediation and compensation programs.

Independent reviews have been conducted into how banks pay and reward staff (Sedgwick Review) and into how banks interact with customers and the operation of the Code of Banking Practice (Khoury Review), both of which have made significant recommendations to improve banking practices and standards.

Banks are working through a substantial program of engagement with stakeholders on implementing the recommendations of both these reviews, including making changes to the way they pay and reward their staff and undertaking a comprehensive redraft of the Code of Banking Practice.

ABA position

The ABA's Banking Reform Program is a self-regulatory initiative for the banking industry, with the objectives of improving products, service and culture in banking. However, the ABA is mindful that regulatory reforms, particularly those relating to consumer or financial stability protections should be designed and implemented across the entire financial services industry. Inconsistent standards and practices puts at risk consumers who may not understand when they deal with non-banks that they may not have the same protections.

2.9 Financial inclusion and accessibility

The ABA recognises that some people face difficulties accessing and using banking and financial products and services. This can contribute to not only financial disadvantage, but can also have social and emotional consequences for people being, or feeling, excluded.

A competitive financial system delivers products that fit individual needs, and are inclusive and flexible. To address these difficulties, at an industry level, the ABA has developed a number of programs, including:

- The ABA's Position on Financial Literacy and financial literacy program, *Broadening Financial Understanding*, which has been running for over a decade to help all Australians take control of their money and finances.[17]
- The ABA's Position on Financial Inclusion, which sets out the industry's commitment to promoting financial inclusion and working towards ensuring all Australians have access to, and use of, a number of safe, affordable and appropriate banking and financial products and services.

[16] https://www.betterbanking.net.au/
[17] http://www.bankers.asn.au/Consumers/Financial-Literacy

- The 'Doing It Tough' website and financial hardship program to assist customers who may be experiencing financial difficulties.[18]
- The Indigenous Statement of Commitment, which sets out the industry's commitment to standards of good practice, recognising many Indigenous Australians face significant social, economic and financial disadvantage.
- The financial abuse package to support customers who may be vulnerable to financial abuse and domestic violence or customers who want to plan ahead and manage their financial affairs, especially as they get older.[19]

Additionally, at an individual bank level, many banks currently have programs and product offerings to improve customer outcomes through better products and services at the lowest cost. These include:

- Australian banks offer 'basic bank accounts' that are suitable for their disadvantaged or low-income customers.[20] A basic bank account is a transaction account that does not charge many of the standard bank fees other accounts typically do. There is a competitive marketplace for basic bank accounts and these products have improved over the years.
- Matched savings[21] programs provide incentives for people on low incomes to save money for specific purposes and assist in developing savings goals and long-term savings habits.
- Micro economic development and business enterprise programs to support the development of businesses.[22]
- Low cost, low value commercial credit products.[23]

ABA position

The ABA believes that all financial institutions should be inclusive in dealing with all customers and providing a range of options so customers can choose the most appropriate banking products and services for their circumstances.

2.10 Compensation and financial requirements for AFS and credit licensees

The ABA supports establishing a mandatory, prospective last resort compensation scheme covering financial advisers. To promote the long-term viability of the scheme, the ABA believes that compensation and financial requirements for AFS and credit licensees should be reviewed, to reduce the likelihood that the scheme will be drawn upon. We recognise that not all AFS licensees are financial advice businesses and we do not support the scheme extending to credit licensees. However, this is an opportunity to review all licensees to ensure sufficient compliance and safeguards are in place across the financial system.

Compensation and financial requirements for AFS and credit licensees affect competition as they act as a barrier to entry for participants and require ongoing compliance and capital resources. However, these requirements also go to the viability of the business and act as an important consumer protection. Currently there are around $17 million in unpaid Financial Ombudsman Service determinations by non-bank licensees. These determinations are unpaid because these licensees are unwilling or unable to pay.

[18] http://www.doingittough.info/
[19] http://www.bankers.asn.au/consumers/financial-abuse-prevention/
[20] http://www.affordablebanking.info/
[21] ANZ's Saver Plus program developed in partnership with the Brotherhood of St Laurence and NAB's AddsUP Savings Plan developed in partnership with Good Shepherd Microfinance
[22] NAB's micro-enterprise loans and Westpac's micro-finance program developed in partnership with Many Rivers
[23] WBC launched its new 'Lite' VISA Card, to meet growing demand for access to more affordable credit, bringing flexibility to customers looking for a straightforward credit card with a low interest rate.

To promote a level playing field and improve consumer protections, ASIC should consult on requiring an annual assurance statement from all AFS licensees that they meet their licence obligations, including compliance with *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* [RG 126] and *Regulatory Guide 210: Compensation and insurance arrangements for credit licensees* [RG 210][24]. This consultation should expressly take into account the professional indemnity insurance policy coverage of activities authorised under the insured AFS or credit licence, and the ability of the policyholder to meet the deductible and any reinstatement premiums.

ASIC should also review the compensation requirements under RG 126 and RG 210 to ensure they remain fit-for-purpose.

Similarly, the Government should undertake a formal consultation and review of the financial requirements for AFS licensees under *Regulatory Guide 166: Licensing: Financial requirements* [RG 166] and credit licensees under *Regulatory Guide 207: Credit licensing: Financial requirements* [RG 207], to consider whether capital requirements for AFS and credit licensees remain sufficient.

The ABA believes that any review should take into account whether sufficient resources to compensate clients and meet any insurance deductible payments or reinstatement premiums should form part of the resources required for an orderly wind down of the licensee's business.

ABA position

The ABA believes that ASIC's powers should be strengthened and clarified to ensure financial services providers are required to have and maintain adequate financial requirements and compensation arrangements to obtain and hold an AFS licence. While the ABA strongly supports the introduction of a new mandatory and prospective last resort compensation scheme for financial advice, it is inappropriate to expect banks to cover consumer losses due to the illegal or poor conduct of non-banks.

[24] http://download.asic.gov.au/media/1241336/rg210.pdf

3. Reducing barriers to entry and encouraging innovation

Barriers to entry can be justified in banking to ensure that consumers remain protected and that financial stability is maintained through a well monitored and supervised prudential system.

There are several areas where the ABA believes burdens could be eased but we continue to advocate that APRA maintain discretion to limit entry/ban entities that threaten financial stability or do not offer adequate consumer protections.

This chapter steps through the main issues the ABA identifies could either enhance competition or strengthen consumer protections in the changing competitive landscape.

3.1 Fintech developments for banks and bank supervisors

The Basel Committee on Banking Supervision (**BCBS**) recently released a paper in August outlining the challenges that regulators face in the world of fintech, or new financial technologies. As they noted, the nature and scope of banking risks are likely to change in the coming years with the growing adoption of new financial technologies, or fintech. These changes will arise from both the technologies themselves as well as new business models.

One of the most pressing challenges from both a financial stability and competition perspective is ensuring that regulation and regulators respond to changes in business models that will arise from fintech. As they note, "current bank regulatory, supervisory and licensing frameworks generally predate the technologies and new business models of fintech firms. This may create unintended regulatory gaps when new business models move critical banking models outside regulated environments or conversely result in unintended barriers to entry for new business models and entrants."

As the BCBS say, current supervision models will need to be reassessed in response to these changes to ensure continued effective oversight and supervision of the banking system. This includes looking at all new players from small start-ups to large multinational companies and the role they could play in the new banking landscape and the implications for Australian consumers.

But the BCBS also notes that fintech developments will undoubtedly raise "issues that go beyond the scope of prudential supervision, as other public policy objectives may also be at stake, such as safeguarding data privacy, data and IT security, consumer protection, fostering competition and compliance with AML/CTF."

The fintech challenge for regulators is best summarised in the following paragraph from the BCBS:

> *Banks and bank supervisors should consider how they balance ensuring the safety and soundness of the banking system with minimising the risk of inadvertently inhibiting beneficial innovation in the financial sector. Such a balanced approach would promote the safety and soundness of banks, financial stability, consumer protection and compliance with applicable laws and regulations, including anti-money laundering and countering financing of terrorism (AML/CFT) regulations, without unnecessarily hampering beneficial innovations in financial services, including those aimed at financial inclusion.* [25]

ABA recommendation

The ABA would encourage the PC to look at the prudential and public policy implications, including consumer protections arising from the changing landscape of banking, i.e. the entry of new fintech players and firms, especially those not adopting industry standards and codes like the e-Payments Code.

[25] Bank for International Settlements: Basel Committee on Banking Supervision; *Consultative Document - Sound Practices: Implications of fintech developments for banks and bank supervisors*; (August 2017), p5

3.2 Regulatory sandbox for financial services

The Treasurer announced in the May budget that the Government would legislate to establish an "enhanced regulatory sandbox" to test new financial products and services for a period of 24 months. This follows the introduction by ASIC of a regulatory sandbox at the beginning of 2017.

The ABA broadly supported the introduction of ASIC's regulatory sandbox but believed it should have followed the approach seen in places like Singapore where it was open to all, not limited to new entrants only. So we believe that all AFS licensees should have access to the regulatory sandbox to test new products and services.

One strong argument in favour of an open regulatory sandbox is that it would encourage collaboration between established financial institutions and start-ups. Changing the current regulatory sandbox is justified given the low take-up of the existing ASIC sandbox.

ABA recommendation

The ABA recommends that the regulatory sandbox be modified to be made more accessible for market participants and ensure that the modifications encourage collaboration between existing institutions and start-ups.

3.3 $50 million capital requirements

APRA currently only permits ADIs with Tier 1 capital exceeding $50 million to use the terms 'bank', 'banker' and 'banking' and they have discretion to grant the term above this level. A number of smaller ADIs which are prudentially regulated by APRA may benefit from the use of these terms. Amending section 66 of the Banking Act to allow all ADIs to use the terms will create a more level playing field in the banking sector.[26]

ABA position

The ABA supports modifying the capital requirements required to use the term 'bank' provided that APRA continues to use discretion when required.

3.4 Removing restrictions on the use of the term 'bank'

In July 2017 Treasury released a consultation paper on reducing barriers to new entrants to the banking industry by removing restrictions on the use of the term 'bank'.

The ABA strongly supports reforms which will enhance competition without triggering unintended consequences. Banks play a critical role in the financial system, including through their deposit-taking, payments and lending activities. ADIs enjoy a privileged position of trust, with prudential regulation designed to provide consumers with confidence in the safety of their deposits. In reducing barriers to entry it is therefore critical that APRA has a clear, express and absolute power to prohibit certain ADIs which do not have the ordinary characteristics of banks from utilising the term 'bank'. The proposed APRA powers to make a determination to deny the use of the term where serious or unusual circumstances warrant should also be express and absolute.

There are a number of smaller ADIs which are prudentially regulated by APRA who will benefit from the use of the term bank, however the reforms must not weaken APRA's ability to promote financial system stability in Australia.

[26] http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2017/Reducing%20barriers%20to%20new%20entrants%20to%20the%20banking%20sector/Key%20Documents/PDF/Explanatory%20Memorandum.ashx

ABA position

The ABA supports modifying restrictions on the use of the term ‘bank’ provided APRA continues to use its discretionary powers when appropriate.

3.5 APRA review of licensing

On 15 August 2017, APRA released a discussion paper on proposed revisions to the licensing framework for ADIs. APRA proposes to introduce a phased approach to authorisation, designed to make it easier for applicants to navigate the ADI licensing process.

The phased approach is intended to support increased competition in the banking industry by reducing barriers to new entrants to be authorised to conduct banking business, including those with innovative or otherwise non-traditional business models or those leveraging greater use of technology. In particular, the purpose of the new restricted ADI licence is to allow applicants to obtain a licence to begin limited operations while still developing the full range of resources and capabilities necessary to meet the prudential framework.

APRA’s Chairman Wayne Byres said “APRA’s proposed changes to its licensing approach are intended to deliver benefits to the community through facilitating increased innovation and competition in the banking industry, while still maintaining a resilient, sound and stable financial system.” [27]

ABA position

The ABA supports a review of licensing to streamline new entrants’ regulatory processes. However, all financial services providers and credit providers should be required to maintain adequate financial requirements and compensation arrangements to ensure appropriate consumer protections.

[27] http://www.apra.gov.au/MediaReleases/Pages/17_31.aspx

4. Ensuring regulation delivers competitive neutrality

The ABA's members take the general view that the economy is best served by clear and consistent principles-based regulation that does not favour one set of participants over another without well-founded justification.

ABA members believe that Australia has been served well by our prudential regulatory environment with no bank failing in Australia since the 1930s. Our well designed regulatory system provides international investors with the confidence to finance our banks with the capital they need to fund lending to Australians. However, the experience of the ABA's members within this regulatory environment differs and as such there are divergent views on the appropriate regulatory settings.

This chapter outlines the ABA's members' views on how prudential regulation impacts the competitive environment and where competition could be enhanced.

4.1 APRA "unquestionably strong" capital benchmarks and Basel III reforms

Prudential reform in Australia in recent years has been driven by both domestic and international policy. Domestically, the 2014 Financial System Inquiry (**FSI**)'s recommendation that Australia's bank capital be "unquestionably strong" as well as the ongoing international prudential reforms led by the BCBS known as the reforms to Basel III.

APRA has announced its proposed implementation of capital standards to produce unquestionably strong capital ratios, which will also incorporate changes to the prudential framework from Basel III reforms once they are finalised.[28 & 29]

The FSI noted the benefits of a strongly capitalised banking system recognising Australia's reliance on foreign borrowings and the need to ensure that Australia's financial system continues to provide its core economic functions, even in times of stress, and the benefits that flow from reducing the perception of an implicit government guarantee and the associated economic inefficiency this creates.

The Basel III reforms once finalised are likely to result in significant changes to the risk-weighting framework, and include revisions to:

- Both the standardised and Internal Ratings Based (**IRB**) approach to credit risk
- The operational risk framework, including the removal of the advanced measurement approaches
- The credit valuation adjustment risk framework; and
- The introduction of a capital floor for internal model-based methods, based on standardised approaches.

The BCBS has also released changes to the capital framework that APRA has not yet instituted, including the standardised approach for measuring counterparty credit risk exposures and the market risk framework (also known as the fundamental review of the trading book).

While the finalisation of Basel III may include transitional arrangements to phase in any new requirements, possibly at national discretion, APRA considers that a fully phased-in implementation is most likely to align with the aim of the timely implementation of the framework for unquestionably strong capital ratios. However, no decision will be taken by APRA on this issue until the final Basel III framework is published and its impact can be fully assessed. The publication of the final Basel III framework could happen by the end of 2017.

[28] APRA announces 'unquestionably strong' capital benchmarks, (19 July 2017), http://www.apra.gov.au/MediaReleases/Pages/17_23.aspx
[29] APRA INFORMATION Paper, (19 July 2017) Strengthening banking system resilience – establishing unquestionably strong capital ratios, http://www.apra.gov.au/adi/Documents/Unquestionably%20Strong%20Information%20Paper.pdf

The BCBS has largely completed the technical work (often referred to as Basel IV) needed to complete the revisions to the Basel III framework. The one piece of unfinished business relates to the calibration of the output floor. The calibration of the aggregate output floor is a critical piece of work.

The output floor serves to guard against excessively optimistic assessments of risk, which may arise due to a lack of stress in historical data or incentives for banks to underestimate their risk-weighted assets when using internal models. A further reason for the output floor is, according[30] to William Coen, Secretary General, BCBS is *"to even up the playing field by limiting the differences in capital requirements between banks using internal models and those of banks using standardised approaches".*

APRA expects that any changes to the capital framework that may eventuate from the finalisation of the international reforms will be able to be accommodated within the calibration of 'unquestionably strong' and will not necessitate further increases to requirements at a later date.

ABA recommendation

The ABA strongly recommends that the PC should take into consideration the likely impact of the finalisation of the Basel III changes if it decides to make recommendations regarding the capital framework. We also believes that any recommendations should be made in collaboration with APRA and Treasury.

4.2 Australia's ADI capital framework allows two approaches to determining risk-weights

Australia's ADI capital framework is best described by APRA.[31]

The two approaches to determining risk-weights are:

- The standardised approach uses a common set of risk-weights that seek to reflect general risks of different asset classes. These are not tailored to a specific ADI and are set at a conservative level to ensure adequate capitalisation to cover risk.
- The IRB approach uses an ADI's internal model to assess risk at a granular level for the asset and institution. Achieving accreditation to use the IRB approach requires a strong and sophisticated risk management framework and capacity, and includes some more stringent specific requirements that are different to the standardised approach. The two approaches are broadly but not directly comparable at a risk-weight level.
- For residential mortgages, IRB ADIs are currently subject to arrangements that are expected to generate, on average, a risk-weight of at least 25 per cent for standardised ADIs (the average risk-weight is in the order of 39 per cent).

The difference in risk-weights most directly has an impact on the amount of capital required for a given portfolio of loans.

Assuming a 25 per cent risk-weight for IRB ADIs, a 39 per cent risk-weight for standardised ADIs, and a target Common Equity Tier 1 (**CET1**) capital ratio of 9 per cent, the difference in risk-weights between the standardised and IRB approaches equals a difference in CET1 capital requirements of approximately $19 billion (14 per cent), in aggregate, for the four major banks' current Australian residential mortgage portfolios.

The difference in capital requirements will also impact on ADIs' profitability. For a given portfolio of loans, an ADI with a higher risk-weight will generate a *lower* measure of profitability, e.g. ROE.

[30] William Coen. Secretary General, Basel Committee on Banking Supervision, (25 May 2017) Regulatory equivalence and the global regulatory system, http://www.bis.org/speeches/sp170525.pdf Keynote address at the International Financial Services Forum, London
[31] RESPONSE BY THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (APRA) TO A QUESTION TAKEN ON NOTICE, (4 Oct 2016), House of Representatives, Standing Committee on Economics, Inquiry into Australian Prudential Regulation Authority annual report 2015

The implications of this difference will depend on the impact on an ADI's overall cost of funding, which will in turn depend on the ADIs' cost of debt, cost of equity, required capital ratio, tax rate, and change in risk-weight. A simple but conservative APRA example suggested an impact of around 14 bps.

Assuming an ADI with a:

- Pre-tax cost of debt of 3 per cent
- Post-tax cost of equity of 10 per cent
- Target CET1 capital ratio of 9 per cent
- Tax rate of 30 per cent
- Risk-weight for IRB ADIs of 25 per cent; and
- Risk-weight of 39 per cent for standardised ADIs.

then the IRB approach provides a pre-tax funding cost advantage of approximately 14 bps.

This is estimated as follows:

	IRB RWs (25%)	Standardised RWs (39%)
Loan portfolio	$100	$100
Funded by:		
Required capital	$100 x 25 per cent x 9 per cent = $2.25	$100 x 39 per cent x 9 per cent = $3.51
Debt funding	$100 - $2.25 = $97.75	$100 - $3.51 = $96.49
Funding cost:		
Pre-tax cost of equity	($2.25 x 10 per cent)/(1 – 30 per cent) = $0.321	($3.51 x 10 per cent)/(1 – 30 per cent) = $0.501
Cost of debt	$97.75 x 3 per cent = 2.933	$96.49 x 3 per cent = $2.895
Total funding cost	$0.321 + $2.933 = $3.254	$0.501 + $2.895 = $3.396
Funding cost difference	$0.142	

APRA stated that in practice, it is likely that the difference between the two approaches will be slightly narrower than the estimated 14 bps.[32]

The analysis above, for example, does not take into account the capital requirement for interest rate risk in the banking book, which applies only to IRB ADIs. In addition, as a result of the decision to raise average risk-weights for IRB ADIs to *at least* 25 per cent, the actual risk-weight for individual IRB ADIs is likely to be slightly above this level. For each 1 per cent, the actual IRB risk-weight is above 25 per cent, the difference in funding costs is reduced by approximately 1 bps. It is also worth noting this relatively simple example does not take into account other factors like the implicit guarantee, the domestic systemically important banks **(D-SIBS)** charge and the major bank levy discussed later in this submission.

[32] Ibid

One point worth noting is that the APRA analysis is at a whole of portfolio level. There are a number of other factors that influence funding costs for ADIs and these factors can be different depending on whether an ADI is an IRB bank or on the standardised approach. Individual banks will address these factors in their submissions, but as a whole, the ABA's smaller members note that the risk-weight differential impact is felt more in particular parts of the portfolio such as loan-to-valuation (**LVR**) ratio owner-occupier mortgage lending.

The PC should also consider how the prudential framework for ADIs creates a distortion in that non-ADI lenders are able to compete without any of the prudential oversight that ADIs are subject to, e.g. shadow lenders.

As the lending market evolves and transforms, it is only logical that all types of lenders need to play their part in contributing to systemic stability of the Australian financial system while also being held to a standard to ensure good outcomes for customers. These existing gaps between ADIs and non-ADIs potentially undermines APRA's ability to promote financial stability. Enhancing competition is a good outcome for consumers, however reforms must not weaken APRA's ability to promote financial system stability in Australia.

ABA recommendation

The ABA recommends the PC should consider how the prudential framework for ADIs creates a distortion in that non-ADI lenders are able to compete without any of the prudential oversight that ADIs are subject to, e.g. shadow lenders.

4.3 APRA's macro prudential measures

APRA has stated that residential mortgage loans have always constituted a material proportion of the loan portfolios of Australian ADIs.[33]

In response to perceived increasing risks from mortgage lending, APRA has instituted a number of prudential measures, including:

- Improvements to reinforce sound loan underwriting practices, including more prudent assessment of borrower income and expenses, and additional buffers to allow for future increases in interest rates[34]
- Increasing the amount of capital required for Australian residential mortgage exposures by IRB ADIs, consistent with the FSI's recommendation to "raise the average IRB mortgage risk-weight to narrow the difference between average mortgage risk-weights for ADIs using IRB risk-weight models and those using standardised risk-weights"[35]; and
- Establishing benchmarks designed to moderate higher-risk lending, including on the rate of growth in lending to property investors, and on the proportion of lending on an interest-only basis.[36]

Importantly for this inquiry, the revised Basel III framework, once finalised, will likely modify standardised risk-weights for higher LVR loans, and identify separate risk-weights for investor lending. As part of its implementation of revised standards, APRA will ensure these measures are also appropriately reflected in the IRB framework.

[33] APRA INFORMATION Paper, (19 July 2017), Strengthening banking system resilience – establishing unquestionably strong capital ratios, http://www.apra.gov.au/adi/Documents/Unquestionably%20Strong%20Information%20Paper.pdf

[34] APRA outlines further steps to reinforce sound residential mortgage lending practices http://www.apra.gov.au/MediaReleases/Pages/14_30.aspx (9 December 2014)

[35] APRA increases capital adequacy requirements for residential mortgage exposures under the internal ratings-based approach, http://www.apra.gov.au/MediaReleases/Pages/15_19.aspx (20 July 2015)

[36] http://www.apra.gov.au/adi/Publications/Documents/Further%20measures%20to%20reinforce%20sound%20residential%20mortgage%20lending%20practices.pdf (31 March 2017)

ABA recommendation

APRA should consider the effects of its mortgage reforms on both ADIs and shadow banking sector.

The caps on investor loan growth have restricted the ability of ADIs to competitively grow investor loan portfolios and opened opportunities for non-ADI lenders. The ABA asks that the PC considers how this has affected competition between players within the market.

4.4 APRA's accreditation process for banks wishing to move to the IRB approach

The FSI suggested that APRA could consider how to make the IRB accreditation process less resource intensive.

Specifically, the FSI Final Report proposed:

> *To promote incentives for ADIs to develop IRB capacity, APRA could also consider how to make the accreditation process less resource intensive without compromising the (necessarily) very high standards that must be met.*
>
> *APRA has already indicated it is willing to explore a proposal to decouple the need to achieve internal model accreditation for both financial and non-financial risks simultaneously. That is, an ADI may be accredited for regulatory capital models for credit and market risks without having been accredited to model operational risk. The Inquiry supports exploring such initiatives.* [37]

As the FSI noted, APRA had been considering possibilities to modify its IRB accreditation process with a view to making it easier for ADIs to achieve accreditation without weakening the overall standards that accreditation requires. In December 2015, APRA announced two important changes to the IRB accreditation process.[38]

4.4.1 Staged IRB accreditation

APRA's policy position is that ADIs seeking IRB accreditation must:

- Be capable of modelling all material credit portfolios; and
- Meet accreditation requirements for all such portfolios before models can be used for regulatory capital purposes.

Staged IRB accreditation refers to a modification of condition two above. Staged accreditation provides the capacity for an ADI to use accredited IRB models for regulatory capital purposes for some credit portfolios ahead of others.

APRA has stated it is open to an ADI adopting a staged accreditation, subject to the following criteria:[39]

1) APRA expects the ADI to present a credible plan for all material credit portfolios to ultimately be brought under the IRB approach.
2) APRA must be confident that the period from accreditation of the initial set of credit portfolios to accreditation of the remaining portfolios will be reasonably short: no more than one to two years.
3) The initial accreditation should cover the larger part of the ADI's aggregate credit exposure.
4) Selection of portfolios for initial accreditation should not be motivated by 'cherry-picking', i.e. the motivation should not be to simply arbitrage between IRB and standardised regulatory capital approaches.

[37] Financial System Inquiry, Final Report, November 2014, p66: http://fsi.gov.au/publications/final-report/
[38] http://www.apra.gov.au/adi/Publications/Pages/IRB-Approach-to-Credit-Risk-Accreditation-Process.aspx
[39] Ibid

5) A significant portion (at APRA's discretion, but at least 50 per cent) of any expected regulatory capital benefit from accreditation would only become available after obtaining complete accreditation. APRA also reserves the right to vary this percentage during the period from initial to final accreditation to reflect the confidence, or otherwise, in the progress towards final accreditation; and

6) Accreditation approval may be withdrawn if APRA forms the view that the anticipated period to final accreditation (see criterion (ii)) will exceed two years from the date of initial accreditation.

According to APRA, these criteria are designed to ensure that the overarching principle that an ADI achieve full IRB accreditation of its credit exposures continues to be adhered to, and that an ADI has incentives to ensure this occurs.

As a practical matter, staged accreditation will require that all key aspects of IRB systems should be in place at the time of initial accreditation, albeit they may be operationally immature for some portfolios. In such cases, staged accreditation would allow an applicant ADI time to bed down (and demonstrate sufficient maturity) in the relevant portfolios. In order to meet the above criteria, APRA has stated that they expect an ADI seeking to take advantage of staged accreditation would be able to:

- Submit a single application covering all portfolios; and
- Demonstrate at the time of initial accreditation, for any yet-to-be-accredited portfolios:
  - Models and risk estimates that have been accepted by APRA, i.e. are considered to meet key IRB minimum requirements relating to calibration and discrimination.
  - Models and risk estimates that have been implemented, which also include a requirement that all exposures have been rated based on the latest models under IRB standard credit risk management control processes.
  - A validation and control framework - consisting of policies, procedures and human capital - encompassing both quantitative and qualitative aspects of ratings and ratings processes is in place.
  - At least two quarters of parallel run have been completed.
  - At least one cycle of annual validation and control processes applied to the latest models and estimates have been completed; and
  - Clear and achievable project timelines for closing outstanding 'gaps' are in place.

ABA recommendation

The ABA supports the FSI observation around improving the accreditation process to move to internal risk-based models. We believe that APRA could proactively partner with standardised approach banks who are seeking internal model accreditation to ensure the process is as seamless as possible.

4.5 Implicit guarantee

Views within the ABA's membership differ on the significance of the Australian Government's implicit guarantee of taxpayer assistance in the event of a crisis.

4.5.1 Are all banks too critical to ignore?

Australians trust their banks as a safe place to store their wealth and as a dependable investment which provides a reliable and steady return over the business cycle. The Government knows that the failure of any bank to repay or service its debts will affect confidence in the whole system and so they have put in place structures to preserve stability.

APRA has always exercised tight control over all aspects of the operation of banks, including capital levels, holding of liquid assets and exposures to risks. The robust nature of the Australian banking system was clearly demonstrated during the GFC.

In addition, the RBA provides a liquidity facility to all banks under which they can obtain very substantial funding at short notice. And retail deposits under $250,000 for all banks in Australia - large and small - are guaranteed by the Federal Government under the Financial Claims Scheme.

During the depths of the GFC there was a three and a half week period when the Australian Government guaranteed all liabilities of all banks for no fee. The whole system was supported, not just the majors.

Subsequently a fee structure for the guarantee of large deposits and wholesale funding came into effect. The Government did not need to pay out under this scheme (no bank was bailed out) but during the time this was in operation it earned Australian taxpayers $4.5 billion.

The last bank failure in which Australian depositors lost money was a trading bank, the Primary Producers Bank of Australia, in 1931. Since the early 1930s, governments have sought to resolve banking industry problems without losses to the public.

For example, in the early 1990s, the state banks of Victoria and South Australia got into difficulty. Their losses were paid for by the taxpayers of those states as their governments had unconditionally guaranteed all liabilities (not just deposits) for these banks. And the business presence of these banks was maintained through their absorption by other institutions. A snapshot of the history of the Federal Government's financial guarantee schemes provides a view of the support provided to the banking system in times of crisis.

- On 12 October 2008, the Rudd Government announced it would guarantee deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies for a period of three years. There was to be no cap on the maximum amount and no fee charged. This was to be legislated as part of the Financial Claims Scheme. This was an explicit, free, deposit guarantee. At the same time the Government also announced a guarantee on wholesale debt securities issued by these same institutions with the intention of charging a fee.
- On 24 October 2008, the Government announced that a threshold of $1 million would be implemented for deposits; deposits under that threshold would continue to receive the guarantee for free; for deposits over that amount a fee would be charged to receive the benefits of the deposit guarantee. Foreign bank branches would be able to access the guarantee for short-term wholesale funding raised from Australian residents at the same premium as applied to other ADIs. Foreign bank branches would also be able to access the deposits guarantee in respect of domestic deposits held by Australian residents for a fee, with no fee-free threshold.
- An interim deed of guarantee operated from 2 to 27 November 2008. This deed was for wholesale deposits and security issues of domestic ADIs, and for wholesale deposits, security issues and retail deposits of foreign ADIs operating in Australia. The difference between domestic and foreign banks reflected the fact that the Federal Government had already stepped in to provide a guarantee to domestic individual depositors under the Financial Claims Scheme. There was no mention of a fee so for this three and a half week period all debt liabilities of all ADIs in Australia were guaranteed for free.

- The interim deed flagged that a separate facility for the guarantee of certain liabilities would be available after 27 November 2008, so the deed was clearly a stop gap.
- On 28 November 2008 the fee structure for large deposits and wholesale funding came into effect.
- On 7 February 2010, the Government announced the withdrawal of its Guarantee Scheme for Large Deposits and Wholesale Funding, effective 31 March 2010. Existing guaranteed wholesale funding liabilities and term deposits would be guaranteed until maturity, with call deposits guaranteed to October 2015.
- On 11 September 2011, the Treasurer announced a number of changes to the Financial Claims Scheme, including a new permanent cap of $250,000 per person, per ADI, to take effect from 1 February 2012.

What this shows is that in the depths of the GFC, the Government was prepared to back all deposits for all Australian ADIs without limit with an explicit guarantee. There was no distinction between ‘too big to fail’ and other ADIs – all were covered. Historically, the preferred method of resolving financial institutions in trouble has been to arrange their absorption by larger and stronger ADIs rather than to let them fail, which occurred in Australia in the aftermath of the GFC. This supports the view that all banks benefit from an implicit guarantee and the banking system is capable of resolution.

Credit ratings agencies continue to distinguish between banks, although this treatment differs between agencies, with credit uplifts for banks which they judge domestically systemically important and likely to receive Government support in times of difficulty. The ABA believes this distinction over-simplifies the Australian political environment, and that consideration should be given to the reality that in times of crisis all banks would be too critical to ignore.

ABA recommendation

The ABA asks that the Government confirms its support for all Australian ADIs in periods of crisis. We note that the PC also acknowledged that impact on the likelihood and extent of any government assistance that would be needed from reforms to strengthen the banking system like TLAC, crisis resolution, unquestionably strong reforms as well as the RBA’s CLF. Articulation of the government’s commitment to ADIs is needed in light of the credit ratings agencies’ perception of differing levels of government support between Australian ADIs and the consequent impact on their credit ratings.

4.5.2 The value of the implicit guarantee

The ABA believes it is hard to quantify the value of the implicit guarantee and that its regulatory landscape, including TLAC and reforms to Basel III, means the value is likely to fall over time. We do know however, that recent ratings agency action (see section 4.5.3) highlighted that ratings agencies believe there to be an implicit guarantee for the four majors while the Government also justified its Major Bank Levy on the basis of recouping value from the implicit guarantee.

APRA, at a recent parliamentary hearing flagged the difficulty in quantifying the implicit guarantee. APRA stated that the implicit guarantee is implicit in the sense that it is perceived to be there.[40]

APRA also referred to the introduction of TLAC in Australia, in that APRA is set to introduce measures for the largest banks that reduce the probability that that perceived guarantee would ever need to be used.

[40] Commonwealth of Australia, Proof Committee Hansard, Economics Legislation Committee, Estimates, (Public), Tuesday, 30 May 2017, Canberra

APRA stated:

> *The implicit guarantee is implicit in the sense that it is perceived to be there. It is very difficult to do anything about the perception. The way in which the regulatory community—I am talking here about the global regulatory community—is responding to that since the financial crisis is to try to introduce measures for the largest banks that reduce the probability that that perceived guarantee would ever need to be used anyway. If you think it is never going to be used it has no value.*[41]

An internal RBA research paper, released as part of a freedom of information (**FOI**) request, is one of the few sources of analysis on whether large Australian banks receive an implicit public subsidy.[42] The analysis is now dated.

4.5.3 Total loss absorbing capacity (TLAC)

The Government's response to the FSI report endorsed APRA to implement the FSI's recommendation that Australia "implement a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of Australian ADI and minimise taxpayer support." The Government noted that this would be work that extended beyond 2016.

International thinking in this area has been led by the Financial Stability Board (**FSB**), which will require globally-systemically important banks (**G-SIBs**) to have a minimum amount of TLAC over and above their minimum capital requirements. Although no Australian bank has been designated as a G-SIB, the basic objective of facilitating orderly resolution and minimising the risk of taxpayer support is the same as that which led to the FSI's recommendation.

APRA has publically stated that implementing an Australian TLAC regime will not only bolster the resilience of the system and minimise potential taxpayer support in times of stress, but help the competitive landscape by reducing the implicit subsidies that come from perceptions of 'too big to fail' and the associated reduction in market discipline.

4.5.4 Ratings downgrade

On 21 May 2017, Standard & Poors Global Ratings (**S&P**) downgraded the banking industry country risk assessment (**BICRA**) score for Australia from 2 to 3.[43] This was because of *"strong growth in private sector debt and residential property prices in the past four years, notwithstanding some signs of moderation in growth in recent weeks".* This downgraded the economic risk score from 3 to 4, which feeds into the BICRA.

The BICRA is the starting point for all Australian bank ratings, and gives each bank an anchor rating from which banks can gain or lose notches through stand-alone credit profile (**SACP**). Banks can improve on their SACP to obtain a higher issuer rating through various factors, including their business, ratings risk-adjusted capital ratio (**RAC ratio**), government support or parent support. The downgrade of the BICRA lowers all banks' SACPs anchors. The economic risk score is also used to calculate the amount of capital banks have to hold for the RAC ratio. The downgrade in the economic risk score increases the amount of capital the banks have to hold if they wish to maintain their previous RAC ratio levels.

- The four major banks did not have their issuer ratings downgraded because of S&P's expectation of likely timely financial support from the Australian government.
- Macquarie Bank did not have its issuer rating downgraded because of superior ratings capital levels.

[41] Ibid
[42] Do Large Australian Banks receive an implicit public subsidy? http://www.rba.gov.au/information/foi/disclosure-log/pdf/151609.pdf
[43] Asia-Pacific Banking Update: S&P Global Ratings, (21 May 2017), Ratings of 23 Australian Financial Institutions Lowered on buildup of Economic Imbalances

- Suncorp did not have its issuer rating downgraded because of parent support.
- 23 Australian financial institutions were downgraded, including Bank of Queensland and Bendigo & Adelaide Bank who moved from the A category to a rating of BBB+.
- No foreign institutions operating in Australia were downgraded because they have parent support.

The deterioration in the ratings agencies' view of the fundamentals of the Australian economy are now reflected in the BICRA which has impacted the non-major banks the most. Non-major banks report it is now more expensive to compete on wholesale funding costs.

The change in the BICRA score will also impact the larger banks which will be required to pay both the major bank levy and hold more capital to support their ratings in the future.

Note that under their status as D-SIBS the major banks are subject to additional capital requirements.[44] They are required to hold an additional 1 per cent CET1 buffer over and above that held by other ADIs. In the example presented in Section 4.2, APRA assessed the value of this increased capital requirement as valued at 3 bps. In the funding cost estimates above, and assuming the IRB bank maintains a 1 per cent higher CET1 ratio, i.e. 10 per cent rather than 9 per cent, the funding cost differential between an IRB and standardised bank is reduced from 14 to 11 bps. However, we note this comparison assumes that all banks have the same pre-tax funding cost (and by implication credit rating).

4.5.5 Major bank levy

The ABA acknowledges that a number of non-major banks support the bank levy on the grounds that they believe it will contribute to a more level playing field. The ABA endorses a strong and competitive banking industry.

The ABA voiced concerns about the levy on the following grounds:

- The imposition of a new tax on selected banks, with no sunset clause, leaves open the possibility that its base will be broadened and the rate lifted by future governments, thereby increasing the impact and possibly extending to other banks.
- The assertion that a new tax can be "absorbed" is erroneous, it will have to be borne by savers, borrowers, shareholders, employees, suppliers or a combination of all, and the public is entitled to know this.
- The imposition of a new tax on five companies that are profitable sets a worrying precedent for other successful Australian businesses.

4.6 APRA crisis resolution

In the wake of the GFC, the then-Government introduced a series of legislative reforms to enhance prudential regulation and consumer protection, including through measures such as the Financial Claims Scheme (introduced in 2008), and the *Financial Sector Legislation Amendment (Prudential Refinements and Other Measures) Act 2010*. This was followed by the Government issuing a consultation paper, *Strengthening APRA's Crisis Management Powers,* in 2012, which canvassed a large package of measures aimed at strengthening APRA's crisis management powers.

The consultation process was put on hold pending the outcomes of the FSI. The final report of the FSI, delivered in December 2014, recommended that the Government complete these reforms (Recommendation 5). In responding to the FSI, the Government agreed that regulatory settings should provide regulators with clear powers in the event that a prudentially regulated financial entity or financial market infrastructure fails.

[44] APRA releases framework for domestic systemically important banks in Australia, (23 December 2013), http://www.apra.gov.au/mediareleases/pages/13_40.aspx

The Government is committed to introducing the crisis management toolkit legislation to strengthen APRA's crisis management powers in the spring 2017 sittings of Parliament. The bill will make amendments to legislation including the *Banking Act 1959*, *Insurance Act 1973*, *Life Insurance Act 1995*, *Australian Prudential Regulation Authority Act 1998*, *Payment Systems and Netting Act 1998* and the *Financial Sector (Business Transfer and Group Restructure) Act 1999*.

ABA recommendation

The ABA is supportive of the crisis resolution reforms and strongly believes that adequate consultation (greater than 21 days provided by Treasury) on the exposure draft legislation would have been preferred to yield a well-designed Australian regime that works together with existing prudential frameworks, efficiently implemented to support the financial system and achieve the consumer outcomes intended without complex and costly unintended consequences.

4.7 New APRA powers to address financial stability risks - non-ADI lender rules

As the RBA noted in its April 2017 Financial Stability Review "the tighter post-crisis prudential framework for the regular banking system creates a risk that credit provision will migrate to the less regulated shadow banking sector."[45] In Australia, shadow lenders comprise a small part of the market, but nevertheless warrant attention from regulators to ensure their systemic risk to the financial system remains limited.

Shadow banking comprises just 6 per cent of financial system assets in Australia compared with over 10 per cent in 2007, and is considerably smaller than in a number of large economies. As the RBA said, systemic risks to the financial system are also limited by the small linkages shadow banks have with the prudentially regulated financial sector, with banks' exposures to the sector only around 4 per cent of total financial assets.

The ABA supports Treasury's proposals to provide APRA with some additional powers in respect of the provision of credit by entities that are not ADIs (**non-ADI lenders or shadow banks**); powers which complement, but not equate to APRA's existing powers in respect of ADIs.

Systemic trust in the financial sector comes from customers being able to trust all financial institutions within the system, regardless of whether they are (or are associated with) an ADI.

As the lending market evolves and transforms, it is only logical that all types of lenders should play their part in contributing to systemic stability of the Australian financial system while also being held to a standard to ensure good outcomes for customers.

The ABA acknowledges the existing role ASIC has in regulating non-ADI lenders that hold either an AFS licence or a credit licence as granted by ASIC. APRA's additional powers will allow them to make rules relating to the lending activities of non-ADI lenders, where APRA has identified material risks of instability in the Australian financial system. This will promote financial stability through strengthening APRA's ability to respond to developments in non-ADI lending that pose a risk to financial stability. Given APRA currently has no such ability with respect to non-ADI lenders, this existing gap potentially undermines APRA's ability to promote financial stability, as lending practices that APRA has curtailed or prohibited for ADIs may continue to be pursued by non-ADI lenders.

The proposed powers also fulfil Australia's commitment[46], as a member of the FSB to implement the following FSB recommendations.

[45] http://www.rba.gov.au/publications/fsr/2017/apr/pdf/financial-stability-review-2017-04.pdf
[46] Assessment of shadow banking activities: risks and the adequacy of post-crisis policy tools to address financial stability concerns http://www.fsb.org/2017/07/fsb-publishes-assessment-of-shadow-banking-activities-risks-and-the-adequacy-of-policy-tools/ (3 July 2017)

- Enhance system-wide oversight of shadow banking and policy responses to address the identified risks by: (i) establishing a systematic process for assessing financial stability risks from shadow banking, and ensuring that any entities or activities that could pose material financial stability risks are brought within the regulatory perimeter; (ii) addressing identified gaps in risk-related data; and (iii) removing impediments to cooperation and information-sharing between authorities.
- Strengthen the monitoring of shadow banking activities and data collection.
- The ABA notes that the FSB has not identified other new financial stability risks from shadow banking that would warrant additional regulatory action at the global level. However, since shadow banking evolves over time, authorities should continue to monitor vigilantly and address promptly emerging financial stability risks.

ABA position

The ABA supports increased powers to APRA to ensure that shadow banks are monitored effectively.

4.7.1 Payday lending

The ABA believes the payday lending industry needs to be regulated more to prevent predatory lending to vulnerable customers. The banking industry is committed to promoting financial inclusion and working towards ensuring all Australians have access to, and use of, a number of safe, affordable and appropriate banking and financial products and services.

The regulation of small amount credit contract (**SACC**) and payday loans should ensure that these products are appropriate and affordable where provided and that it should protect vulnerable consumers. The sector must be appropriately regulated, ensuring all credit providers are subject to responsible lending provisions under a level playing field and greater competition encouraged.

The ABA welcomed the recent review of SACC laws[47] to address certain market and regulatory failures on the part of those credit providers. However, further regulation of SACC is required, including greater transparency of fees and charges to allow consumers the ability to compare the cost of credit and to make informed choices.

ABA recommendation

The ABA supports the Government's strong response to payday lenders and believes further action is warranted.

4.8 Financial services regulation

The ABA strongly believes that regulatory reforms, particularly those relating to consumer protection or financial stability should be designed and implemented across the entire banking and financial services industry.

For example, the Government has proposed the new Banking Executive Accountability Regime (**BEAR**). The ABA believes the BEAR should operate to preserve competition, promote consistent consumer protection, enhance accountability, and lift standards across the entire financial services industry. One way to achieve this is for the BEAR to apply consistently across APRA's regulated population from its inception. For example, a standalone APRA-regulated insurer should be held to the same standard as an insurer within a banking group. [48] This would give customers of non-ADI entities equal protections. Inconsistencies will create competitive and regulatory distortions, but also result in gaps in the consumer protection framework.

Similarly, the Government has announced a range of reforms to credit cards including:

[47] https://consumercredit.treasury.gov.au/content/sacc_review.asp
[48] This was the effect of the UK Prudential Regulation Authority (**PRA**) Senior Insurance Manager Regime (**SIMR**), which came into effect at the same time as the Senior Manager Regime (**SMR**).

- Prohibiting unsolicited offers of credit limit increases
- Requiring that affordability assessments be based on a consumer's ability to repay the credit limit within a reasonable period, and
- Simplifying how interest is calculated.

The ABA supports these legislative changes incorporating product restrictions applying to all credit card providers.

ABA recommendation

The ABA supports ensuring important consumer and financial stability protections apply not just to banks, but other entities that participate in the same financial markets. This will ensure the same standards apply to regulated entities and consumers are not exposed to different practices and safeguards by institutions and firms offering the same products, particularly where consumers may not be aware of these differences.

4.9 Assessing the impact of regulatory reform

The ABA notes that the unprecedented pace of reform across the banking industry diverts resources from within banks to identifying ways to better serve customers.

In addition, the level and number of regulatory reform projects is having a disproportionate cost and resource impact on ADIs, particularly smaller banks. This limits competitiveness and the ability for an ADI to make strategic investments in a range of areas, particularly investment in competition enhancing and data technology which APRA is strongly encouraging.

ABA recommendation

The ABA would welcome the PC's analysis of the extent and likely impact of ongoing regulatory reform and its economic impact especially on smaller ADIs.

5. Encouraging individuals to save and plan for their future

The ABA believes that the banking industry has an important role in supporting Australians to save, responsibly use credit, create wealth and secure their financial wellbeing. In addition to the banking system, the superannuation and retirement incomes system is also essential pre and post-retirement.

To support the objectives of superannuation, the ABA believes that the superannuation and retirement incomes system should broadly be based on the current structure, operation and governance reinforcing the following:

- *Legal and regulatory structure*: Promote certainty via consistent and stable legislative rules and taxation treatment.
- *Market structure*: Provide member focused and competitive product offerings and investment options via innovation in products and services, downward pressure on fees and costs, and technology efficiencies, and
- *Consumer confidence*: Enhance consumer awareness, member engagement and investor understanding of superannuation and private savings.

The ABA believes that efficiencies in the superannuation and retirement incomes system can be gained through improvements in administration, technology, capital, governance and disclosures. Australians must engage with their superannuation and private savings, financial decisions and consumer choices. Therefore, the regulation of the superannuation and retirement incomes system and the offer of superannuation and investment products should focus on removing actual and perceived complexities, reducing unnecessary administrative and operational inefficiencies, promoting member engagement, and enhancing competition in the system.

5.1 Principles on superannuation

The following outlines the principles the ABA believes should underpin an effective, efficient and competitive superannuation and retirement incomes system.

5.1.1 Simplicity

The ABA believes that measures should seek to reduce the complexity of the superannuation and retirement incomes system so that consumers have greater confidence in, and understanding of, methods of private savings and performance of superannuation savings. Better integration of superannuation, social security and taxation systems will promote enhanced superannuation and private savings.

5.1.2 Flexibility

The ABA supports the preservation of superannuation as improving the standard of living for Australians in retirement, but also in addressing the fiscal pressures of an ageing population. However, to offset the inflexibility of preservation, superannuation should be accompanied by incentives to promote the attractiveness of superannuation, flexibility to enable retirees to tailor their retirement incomes and financial investments to their needs, circumstances and preferences, and key messages to raise awareness about the importance of superannuation and long-term savings across our community.

5.1.3 Adequacy and saving

The ABA believes that initiatives to promote financial independence should focus on lifting compulsory and voluntary superannuation contributions, increasing private savings, and enhancing long-term wealth accumulation. Australia's superannuation and retirement incomes system should be promoted through targeted messages that seek to encourage greater superannuation contributions and private savings. Encouraging private savings will go some way to encouraging diversified pre-retirement savings and post retirement incomes and will supplement superannuation savings by enabling greater choice, financial independence, and a higher standard of living in retirement. Improving the private savings environment will also reduce the future fiscal pressure of Australia's ageing population and address longevity risk.

5.1.4 Financial literacy

The ABA believes that to broaden engagement with, and financial understanding of, superannuation and retirement incomes options, financial literacy programs must be implemented in partnership with Government, the banking and financial services industry and the community sector.

5.1.5 Stability and certainty

The ABA supports a superannuation and retirement incomes system that is stable and promotes consumer confidence. Uncertain legislation, inconsistent regulation, changes to superannuation tax structures and rules, confusing disclosures and communications, and unnecessary costs for product issuers, service providers, financial advisers and superannuation members undermines efficiency and effectiveness of the system.

5.1.6 Transparency

The ABA believes that greater transparency will lead to more efficient disclosure and communication about superannuation performance, pricing, governance and service levels. Transparency will ensure that consumers have access to information to assist them make informed choices. Better interaction between superannuation fund trustees and members, innovative online solutions and disclosures will promote enhanced member engagement.

5.2 Better regulation

The ABA believes that the existing superannuation model appropriately manages and supports universal (default) and choice for members. For example, the introduction of 'MySuper' enhanced product options available across the spectrum for consumers and members seeking basic superannuation arrangements through to more detailed, tailored or complex investment options.

However, the most effective means of reducing fees and costs, increasing options for consumers and members in superannuation and promoting competition in the system is not via regulatory intervention into product design, product prices or business models, but by reducing administration costs, supporting operational efficiencies, enhancing competition and transparency via increasing use of technology and e-commerce, and providing a mechanism for product rationalisation of legacy products, and streamlining disclosure and reporting requirements. Attention should focus on targeted reforms that remove impediments to cost effective service delivery and member engagement.

The ABA believes that the underpinnings of the superannuation system should be preserved and changes to regulation and product design and delivery should focus on improvements to enable Australians to better take control of their superannuation contributions and retirement income decisions and to assist in closing the retirement savings gap.

Ultimately, this will require a combination of the following:

- Better integration between superannuation, social security and taxation policy and clarity of the purpose, role and interplay between the 'three pillars'
- Better and more accessible incentives to encourage greater superannuation contributions, support voluntary and private savings, and support the development of retirement products and life risk insurance products which address longevity risk
- Better and more targeted messages about the importance of saving and planning early and the role of superannuation, private savings and investments in retirement planning

- Better research into consumer behaviour and better understanding of the motivations and expectations of Australians towards their workforce participation and retirement lifestyle and income
- Regulation which supports a range of different business models, including financial institutions offering full-service banking, superannuation and investment options taking advantage of economies of scale and responding to customer demand for simplicity, through to specialised financial institutions providing tailored products and/or innovative advisory services
- Strong domestic financial institutions to promote Australia as a financial services centre with expertise in banking, wealth creation and risk management, and
- Improved administration, technology, capital, governance and disclosures to promote efficiencies, institutional resilience, consumer protection and transparency for the benefit of superannuation members.

The ABA believes that Australians should be encouraged to save and plan for their future. Information and targeted incentives will lead to greater interest and commitment in saving and planning early for retirement, as well as persuade those with the capacity to meet their own retirement income provision, not only benefiting individuals' standard of living in retirement, but also more broadly Australia's national savings. Additionally, the ABA believes that Australians should be able to access superannuation and retirement incomes products and services from a range of different financial institutions. However, it will be important that all these financial institutions are regulated consistently, particularly as these institutions are the custodians of other peoples' money, and to ensure financial stability, consumer protection, and a level playing field across regulatory obligations.

5.3 Better financial literacy

The ABA believes that the Federal Government should give consideration to building on existing financial literacy efforts to raise awareness of the importance of superannuation, private savings and investments and ensure that consumers, members and retirees have access to the information, guidance and financial advice they need.

Financial literacy is an important part of the superannuation and retirement incomes system. Basic information about superannuation, savings and retirement planning should be readily available and accessible to assist Australians save and plan for the future. It is important that financial literacy programs and initiatives are targeted at raising awareness about the importance of superannuation and are supported by sustainable strategies which encourage individuals to take more responsibility with managing their superannuation and other private savings as well as provide individuals with the necessary knowledge, skills and capacity (financial capability) to put in place savings strategies suitable to their pre and post retirement needs and circumstances.

The ABA and its members have demonstrated a long-term commitment to promoting consumer understanding and financial literacy. For example, the ABA's financial literacy program – *Broadening Financial Understanding* – has been running for around 15 years.

As part of this program, the banking industry has published a number of financial literacy resources to assist consumers better manage their finances, held regular financial literacy events to encourage program partnerships, and promoted key messages about superannuation aimed at addressing the problem that many consumers and members do not feel confident in making decisions about their finances or managing their savings, including superannuation.

Individual banks have also invested in financial literacy programs, including in partnership with consumer and community organisations.

The ABA believes it is important for the public and private sector to work together to better promote savings messages as well as better inform consumers of options available to them to assist them take responsibility for their superannuation and private savings.

While superannuation estimates, retirement income projections and realistic life expectancy tables are invaluable tools for individuals in understanding the implications of the impact of their savings and investment decisions on their standard of living in retirement, it is also important for individuals to have the skills to understand their pre-retirement lifestyle choices, attitudes to debt, savings capacities and access to other investments, so that they can plan earlier and better for their retirement. Strategies for improving financial literacy should target those sectors of the community with the lowest levels of financial literacy, as improvements in financial literacy can result in lifestyle gains for individuals of all ages across the community.

The benefits of improved financial literacy are well-informed consumers, greater personal savings and investment opportunities, improved management of household debt and a reduction in the likelihood of periods of financial stress, decreased need for welfare or other government assistance, greater national savings, more efficient markets and increased personal economic security. Strategies to improve community awareness and understanding must seek to assist all Australians make better retirement savings and income decisions.

The ABA believes that a good level of financial literacy is essential for enabling individuals to be both aware of the decisions they need to make about their superannuation and retirement incomes and to make sound decisions about matters such as when they will retire, how much they need (or want) for retirement, what superannuation and retirement incomes products are right for them, and so on. If Australians are to understand the implications of their financial decisions and consumer choices about pre-retirement consumption and savings, then they must have access to information at the right times and the skills to use that information. Therefore, we consider that Federal Government strategies should seek to encourage individuals to take more responsibility with managing their superannuation and other private savings.

The ABA believes:

- Financial literacy actions and outcomes around superannuation should be specifically incorporated into the new national strategy on financial literacy. Specifically, ASIC, in collaboration with the superannuation and financial services industry, and as part of a national strategy on financial literacy, should undertake further work to promote the importance of superannuation and private savings.
- Ensure consumers and members have an appreciation of superannuation terminology, investment concepts and superannuation basics as well as an understanding of the options available to them in terms of products and services available from a range of different financial institutions.
- Encourage Australians to access education, information and financial advice about money management, savings, retirement and estate planning.
- Publish basic, neutral information about superannuation developed around ‘information seeking opportunities’ or ‘teachable moments’, i.e. life stages and events where people need to make consumer and financial decisions, and
- Measure levels of financial literacy and behavioural change towards superannuation to ensure that the importance of planning for retirement has been made and translated into behaviour and action.

Disclosure requirements should be rationalised and modernised to allow disclosures to be provided to individual investors with targeted information suitable to various types of financial products and investments and in different ways via electronic, online and digital methods. The ABA encourages the Government and Treasury to prioritise implementation of FSI recommendation 23 to facilitate innovative disclosure.

Consumer research into consumer behaviour should be conducted. By having a better understanding of the motivations and expectations of Australians towards their workforce participation and retirement, this approach would ensure that strategies for lifting household savings and messages promoting Australians to think about their retirement lifestyle and income as well as their superannuation and private savings are better and more targeted. Understanding the factors that influence individuals' decisions about money, savings, investment, superannuation, debt and lifestyle choices will be important for determining how best to encourage greater personal superannuation contributions and private savings.

The Australian Government Financial Literacy Board should undertake another national campaign to raise awareness of the importance of financial literacy, and in particular, promoting individuals' understanding of superannuation. Key messages should highlight the importance of discretionary and long-term savings. Banks and other financial institutions should coordinate efforts with Government, educators, employers and community sector representatives to target information to the needs of different people during the campaign to encourage Australians to save and plan for their future.

ABA recommendation

The ABA believes that the superannuation system could be improved through targeted reforms to support operational efficiencies and reduce administration costs as well as promote financial literacy for all superannuation members.

Appendix A: Account switching developments

There have been a number of developments over the past five years or so stemming from the then Labor Government's Competitive and Sustainable Banking System package which have addressed key impediments to switching.

- Banning early exit fees on standard variable rate mortgages on loans taken out after 30 June 2011. This removed a key financial impediment to the early payment and refinancing of variable rate mortgages.
- Introduction of the APCA switching initiative from 1 July 2012.
  - This provided a facility by which a new financial institution would do the work of switching regular direct debits and credits from the old account. All customers need to do is open a transaction account at a new financial institution and request that the new financial institution transfer regular direct debits and credits from the old financial institution. The new financial institution advises the billers and payers of the new account details and the customer is advised when the necessary changes have been made. This took much of the pain out of switching by shifting the burden of identifying and transferring direct debits and credits from the customer to the new institution.
  - The protocols governing the processes for actioning account switching are governed by the BECS procedures. These provide agreed timeframes for actioning requests for account switching initiated by the incoming financial institution and for account switching initiated by the customer. Generally speaking, they provide that requests must be actioned within five business days, and notices of variation of account details must be forwarded within two business days. This provides for the relatively rapid turnaround of actioning requests to switch accounts. These protocols are not mandatory or enforceable.
- The introduction of ASIC's MoneySmart website and booklet, which provides simple consumer friendly guidance on borrowing and credit, including how to switch home loans and credit cards. This helped raise consumer awareness of switching options.

There has been extensive consideration of account portability, in particular with a Treasury study in 2011. Full account portability would entail the issue of a unique account number for individuals and businesses, which could be passed to a new institution so that existing direct debits and credits linked to that account could be moved automatically to the account at the new institution, i.e. the payment links to the account would remain in place, with the account itself being switched to a new institution. The prime obstacle to this reform was cost. It would require major re-engineering of the payments system. The study concluded:

> "*Full account portability is not the peg on which to re-engineer Australia's retail payments system infrastructure – it would involve major costs, which would ultimately be borne by payments system users, for relatively minor benefits*."[49]

International initiatives

A development relevant to Australia is the UK Current Account Switch Service, launched in September 2013. This is a free to use service for consumers, small charities, small businesses and small trusts that makes switching current accounts relatively simple. The service is managed and owned by Bacs, the company responsible for Direct Debit and Bacs Direct Credit in the UK.

Most UK banks and building societies in the current account market offer the service. There are now 47 participants with over 99 per cent of UK current accounts covered.

[49] Banking services: cost-effective switching arrangements, Treasury, 2011

The service is backed by a Current Account Switch Guarantee, which outlines how the switching service works and the customer's rights if anything goes wrong with the switch.

Under the service, a customer opens a new current account, decides when they want to switch, and the new financial institution takes care of the rest, including moving all incoming and outgoing payments, moving the outstanding balance and closing the old account.

The service is largely automated but still requires some manual input from the customer. To open a new account the customer must:

- Provide proof of identity and proof of address (which are part of financial institutions' mandatory money laundering checks)
- Complete a Current Account Switch Agreement form and a Current Account Switch Service – Account Closure form.
- Choose a switch date, which must be at least seven working days after the new account has been opened.

There has been some questioning as to whether this initiative was worth the cost. UK banks spent 750 million pounds, but usage has fallen short of expectations. In the 12 months to September 2016 there were 1,059,674 switches (this is not scaled against the base number of current accounts). The industry embarked on a ramped up awareness campaign to boost consumer recognition.

DNB Working Paper – Banking products: you can take them with you, so why don't you? DenederlandscheBank, December 2015

Key points:

- Policy makers around the world call for more competition in the banking industry. One barrier to achieving this goal is consumer inertia.
- The propensity to switch varies across banking products (main current account, savings account, mortgage loan and revolving credit).
- The propensity to switch can be increased by introducing account number portability, whereas more knowledge of the switching service has no significant effect.
- A switching service was created in the Netherlands in 2004 to make current account switching easier. The service entails that the first 13 months after switching to another bank, payments are automatically redirected to the new current account. Payments based on direct debit will be directly withdrawn from the new account. A statement of account provides an overview of all redirected transactions. Although the switching service provides a framework to facilitate switching, customers still have to arrange some things themselves and inform third parties about their new account numbers, for example applying for a debit card, credit card and online banking at the new bank and informing people and companies that deposit money into the new account about the new account number. Although not all consumers are aware of the switching service, informing them of the service, on average, will not significantly increase the switching propensity.

University of Bristol, personal current account switching: Why don't more people switch and what could encourage them to do so? Hartfree, Evans, Kempson and Finney, April 2016

Key points:

- Despite the introduction of the Current Account Switch Service in 2013 to simplify and speed up the process of switching, switching rates in the UK have remained stubbornly low at between four and six per cent a year.

- The UK is not alone in experiencing low levels of switching, with the UK switching rate in line overall with a sample of ten EU countries.
- A number of countries including Sweden, the Netherlands, and Australia, have taken steps to address low levels of switching but none seem to have found a way to significantly improve switching rates.
- Research into the barriers to switching has consistently identified a high level of passivity among current accountholders. The main reason for this appears to be contentment with their current arrangements and the lack of any good reason to make changing necessary, which results in inertia or preference for the status quo.
- The main triggers for people considering switching are either high levels of dissatisfaction (often linked to an error or penalty charge) or a change in circumstances that disrupts existing banking arrangements, e.g. moving home or a bank closure.
- The key barriers are switching costs (and perceived costs) including the loss of a valued relationship, hassle of the process and the fear of things going wrong.
- Account number portability has been proposed as a solution. However, no country has yet gone down this route, primarily because of the cost and uncertain gains in terms of switching.
- Information overload is a barrier to behaviour change. Policymakers need to think carefully about limiting the amount of information presented to people, such as when comparing current accounts. Messages need to address uncertainty and fears, and to be persuasive they need to come from a credible source.
- Most customers would prefer that poor levels of service in the banking industry were addressed, rather than the solution be their having to switch providers in order to get this.

Strong banks – strong Australia

Appendix B: Account switching polling

Please find attached Galaxy Research on Bank Switching commissioned by the ABA and conducted in February 2017.

Strong banks – strong Australia

About the ABA

With the active participation of 24 member banks in Australia, the Australian Bankers' Association provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services.

The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

Bank Switching

n=1000 Australian Citizens surveyed online

Fieldwork dates: 24-28 February 2017

Key Insights

Australians views of the ease of bank switching varies considerable by product. While most find it easy to switch a basic account (57%) or credit card (53%), switching a loan is perceived as hard. Of those who have a mortgage (59%) say it would be difficult to switch their mortgage to another financial institution while among those who have or personal of car loan, 47% say it would be difficult to switch.

Despite this there is strong evidence of competition in Australian banking, with around two-thirds of Australians (62%) having accounts at more than one financial institution.

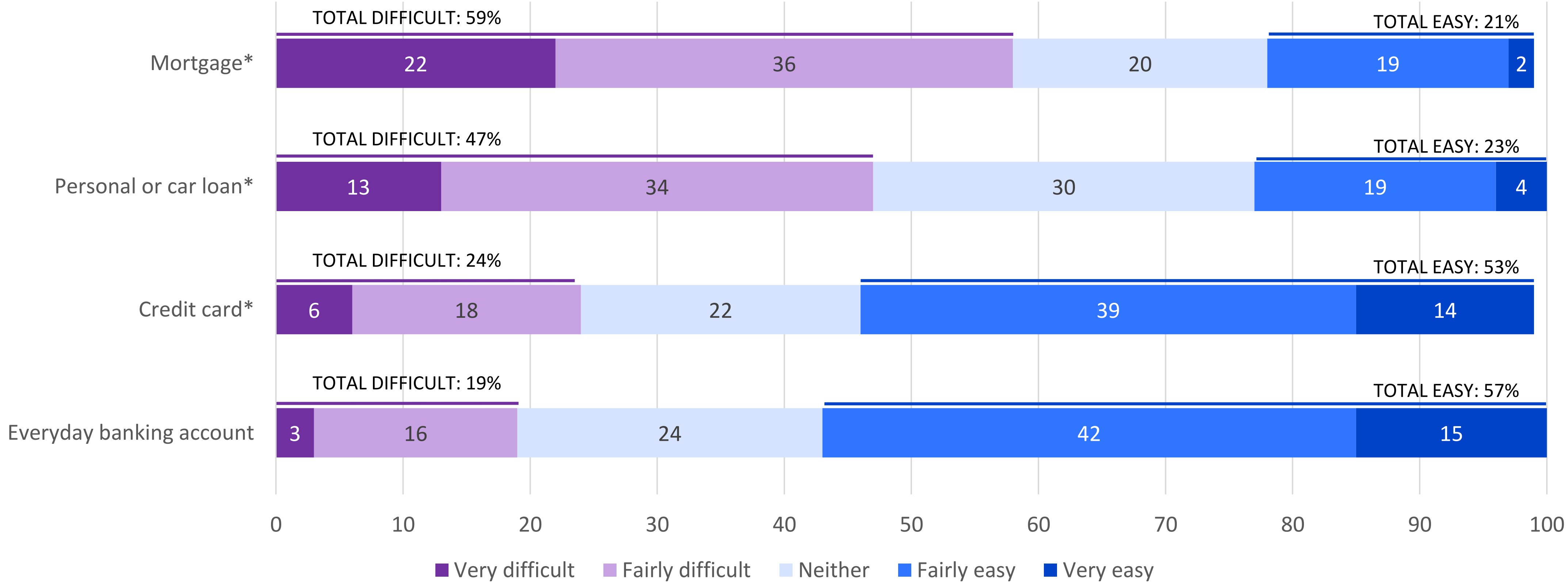
Furthermore, one in five (17%) say they've switched their main bank in the past three years. Of these, 68% said switching was easy, while just 21% said it was hard.

Of those who haven't switched in the last three years, more than half say the reason they haven't switched is that they're comfortable with their current bank (58%). One in five (21%) say there aren't better options available while 9% say they haven't got time to look at other options. Less than one in ten say switching is too difficult (9%).

Those who either have switched and say it was difficult, and those who say the reason they haven't switched is that it's difficult were asked why they felt this way. Three reasons were most commonly cited: the perceived hassle in switching automatic payments, the complexity of the process, and the expectation that it would take too much time and effort.

Perceived ease of switching different bank products

Mortgages and other loans are more difficult; credit cards and everyday accounts are considered easy to switch

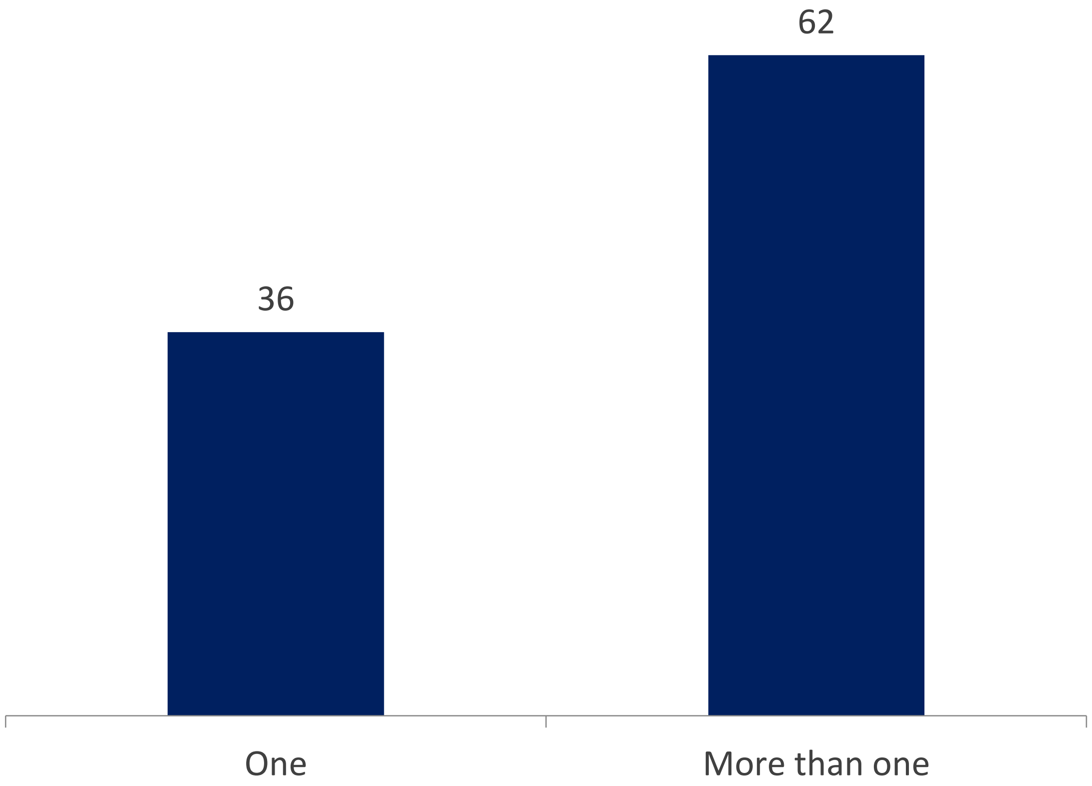


How easy or difficult would you say it would be to switch the following banking products from one financial institution to another one? THOSE WHO HAVE ONE

galaxy research

Most Australians use multiple banks

This may include accounts, credit cards, loans etc.



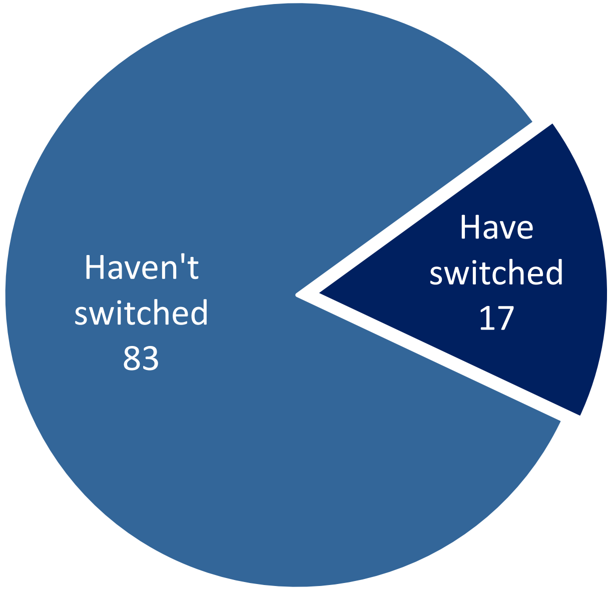
	One	More than one
18-29	48	49
30-39	35	59
40-49	33	65
50-59	34	65
60+	30	70
Rent	45	51
Mortgage	34	65
Own home outright	29	70
No tertiary	45	52
TAFE	38	60
University	27	71

Banking products and services include bank accounts, credit cards, loans etc. A financial institution can refer to a bank, credit union etc. Do you currently have all of your banking products and services at one financial institution, or at more than one financial institutions?

galaxy research

One in five have switched their main bank in the past three years

Switching is more common among those aged under 40

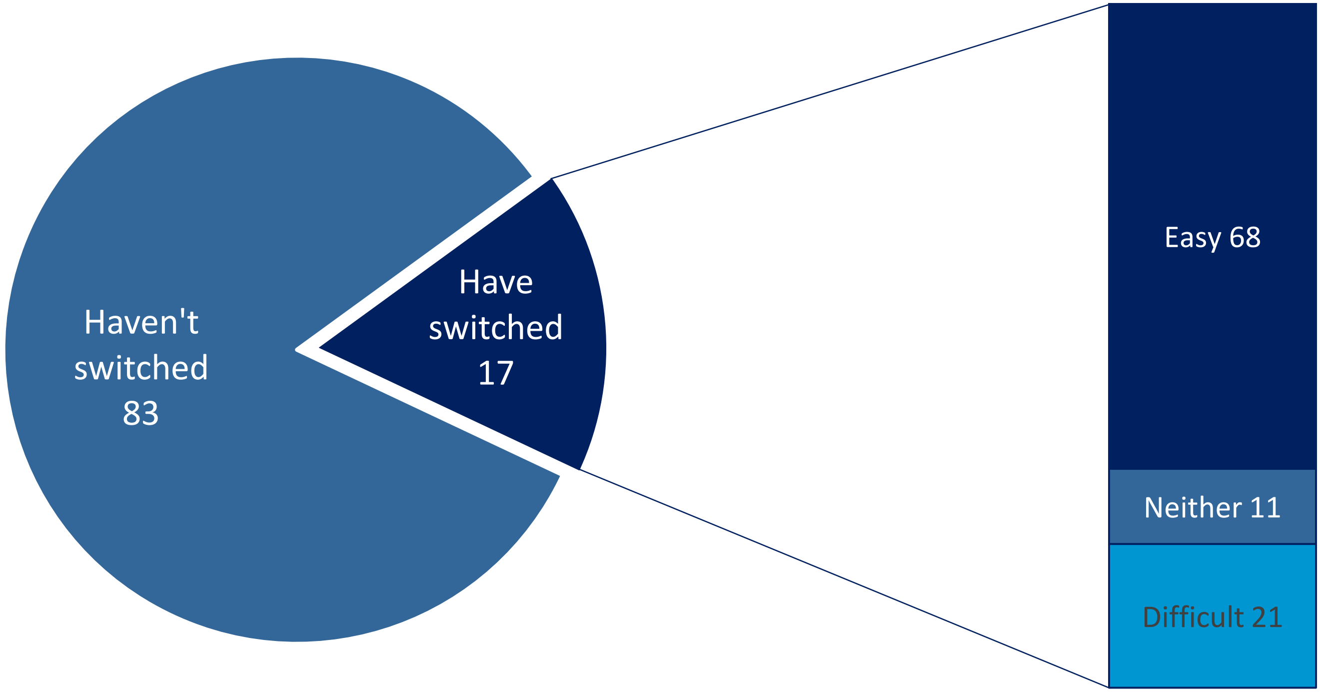


	Have switched main bank
18-29	25
30-39	26
40-49	18
50-59	13
60+	8
Rent	21
Mortgage	21
Own home outright	9

In the questions below, "main bank" means the financial institution that you use for your most important financial arrangements – even if it's not called a bank. Which of the following best describes you: I've switched my main bank at least once in the past three years OR I haven't switched my main bank in the past three years

Most of those who have switched say it was easy to do so

Just one in ten found it difficult

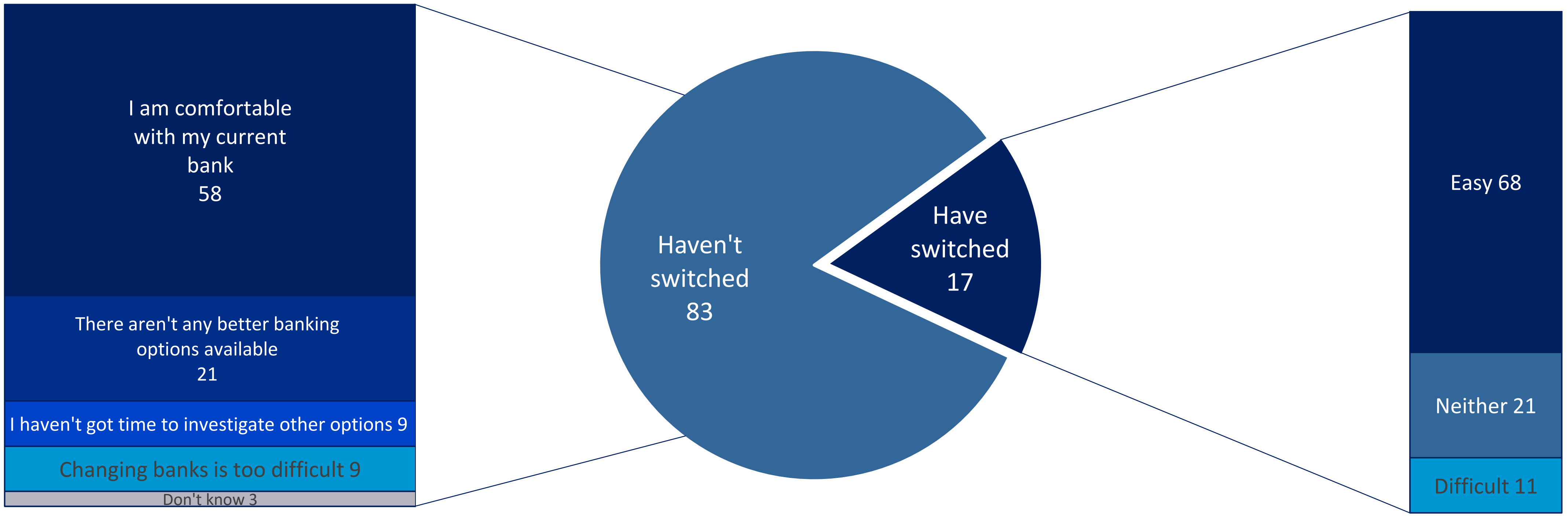


ASKED ONLY OF THOSE WHO'VE SWITCHED THEIR MAIN BANK Did you finding switching banks easy or difficult?

galaxy research

Most of those 'sticking' say it's because they are comfortable

Just one in ten say they've remained with their main bank because it's difficult to switch

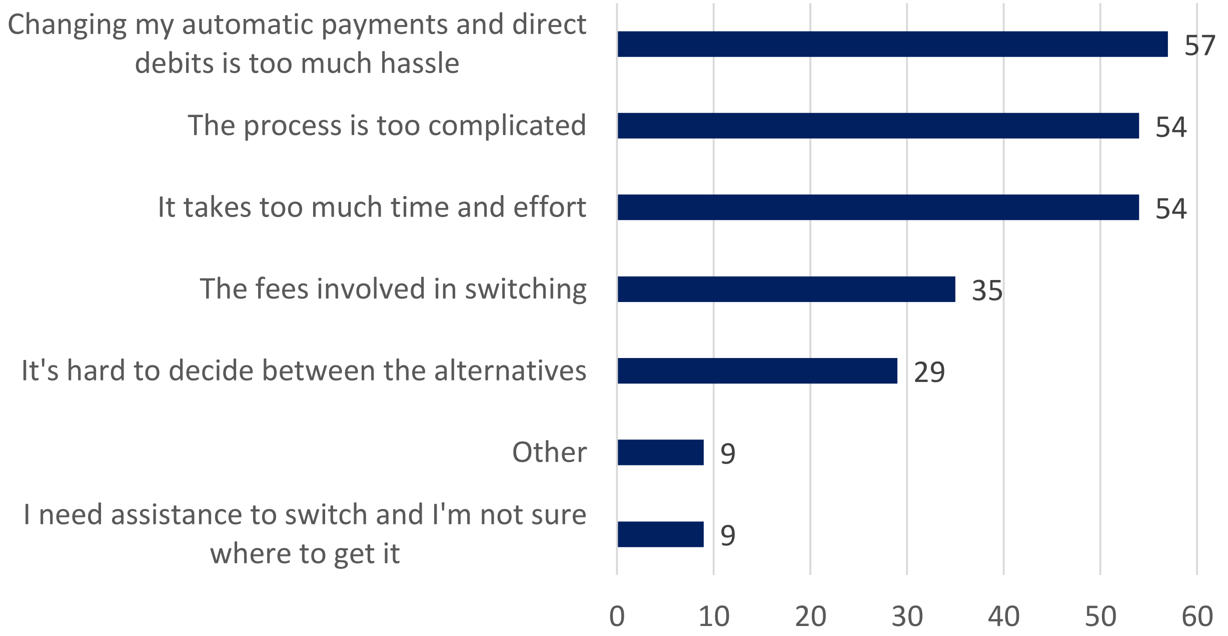


ASKED ONLY OF THOSE WHO HAVEN'T SWITCHED THEIR MAIN BANK What's the main reason you haven't switched your main bank?

Reasons those who say it’s difficult to switch main banks give are:

13%

Have either switched and say it’s difficult to do so
or
Haven’t switched and say the reason is it’s too difficult



ASKED ONLY OF THOSE WHO SAY IT’S DIFFICULT TO SWITCH THEIR MAIN BANK *(9% of 83% = 7.5% 21% of 17% = 4%)
What is difficult about switching your main bank? Multiple responses allowed

For enquiries please contact

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