Initial Submission to the Productivity Commission's Inquiry into Competition in the Australian Financial System

15 September 2017

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Executive summary

The Commonwealth Bank of Australia ("Commonwealth Bank") believes that the Australian financial system has achieved a very successful balance between the important benefits of competition, stability and regulation.

Over the last decade, the level of competition in the Australian financial system has increased, as innovations in technology and changes to regulation have enabled new entrants and smaller competitors to compete effectively, including relative to Australia's four largest banks (collectively referred to as "Australia's Major Banks"). Despite Australia being a small economy, Australian customers have access to world-leading financial service value propositions with high levels of choice, innovation, accessibility and service quality. The intensity of competition in the Australian financial system is on par with other advanced economies and the industry is also highly productive by comparison. These competitive dynamics have delivered high customer satisfaction levels.

The Australian economy has enjoyed an unprecedented period of growth. Given the pro-cyclical nature of financial system performance, the Australian financial system has maintained reasonable returns where returns of other financial systems have cyclically declined due to recessionary conditions in their respective economies. Consequently, the Australian financial system has remained stable and continued to invest in improving customer outcomes. This stands in contrast to peer economies such as the UK, USA and Euro area, where in each case the underlying integrity of the financial system has been under strain and similar investments to improve customer outcomes have not been made (for example, in some countries a sharp decline has been seen in the number of branches).

Strong and stable competitors play a critical role in underpinning prosperity and sustainable growth in the Australian economy. They do this by enabling Australian consumers and businesses to access global capital at competitive rates, and by providing universal access to a broad range of banking services thus helping to secure and enhance the financial wellbeing of people, businesses and communities.

Commonwealth Bank believes that a well-regulated financial system with unquestionably strong banks is critical to protect customers and to support the economy through times of economic prosperity and economic hardship. This is particularly important in Australia where access to global capital is required to fund the Australian current account which has been in deficit for over 40 years.

Australia's current legal and regulatory framework is appropriately balanced to promote customer outcomes through competition while ensuring that the financial system remains stable and customers are adequately protected. Commonwealth Bank recognises the potential benefits to customers of key reforms that are currently underway, most critically in relation to the sharing and use of customer data, and supports these reforms. In this respect, and in the context of rapid evolution of the financial services industry more broadly, Commonwealth Bank supports competition and reforms to ensure customers are protected, financial system stability is upheld, and regulation is uniformly applied to all participants.

Recommendations

Recommendation 1: Commonwealth Bank supports the Australian Government's intention to introduce a regime of open data and comprehensive credit reporting in banking and recommends appropriate measures be put in place to protect customers' privacy and security and uphold the stability of the financial system.

Recommendation 2: The rise of the shadow banking sector, an outcome of non-uniform regulation in the financial system, puts the stability of the system and protection of customers at risk. Commonwealth Bank recommends that legislation and regulatory policy be updated to ensure they apply uniformly to all competitors participating in the financial system.

Recommendation 3: Commonwealth Bank recommends that the anticipated impact of the breadth of statutory and regulatory changes currently being planned or implemented be carefully assessed when considering any further regulatory interventions.

Recommendation 4: Commonwealth Bank recommends that any regulation designed to stimulate competition should give consideration to "through the cycle" implications, in particular the potential risks to customer protection and/or financial system stability in the event of an economic downturn or period of economic volatility.

Chapter 1: Healthy levels of competition across the Australian financial system

Summary

Despite Australia being a small economy, Australian customers have access to world-leading financial service value propositions with high levels of choice, innovation, accessibility and service quality. The industry concentration and structure, including the presence of vertically integrated banks, is similar to comparable countries. Over the last decade, the level of competition and customer choice has increased, in part from new participants and partnerships entering the market. These competitive dynamics have delivered high customer satisfaction levels, as well as a highly productive system.

Australian customers have access to world-leading financial service value propositions

Australian customers enjoy world-leading levels of service and innovation. Australian banks have invested heavily to offer customers high levels of service and convenience in digital channels at the same time as continuing to invest in branch networks and contact centres. Australian consumers' use of online and mobile channels for banking transactions is in the top quartile of banks across the globe: for example, the share of transactions that were mobile and online was 71 percent for Australia's Major Banks' compared to the global median of 36 percent and global best quartile of 54 percent[1]. Commonwealth Bank's CommBank app has been voted as the highest ranked free financial app[2] in Australia. In addition, Commonwealth Bank ranked 6th in Forrester's Global Mobile Banking Benchmark for functionality and usability[3].

Australian customers benefit by having access to among the highest number of branches per capita in the world (29 branches per 100,000 people, refer to Figure 1[4]). Australia is surpassed by the USA (33 branches per 100,000 people). However, it should be noted that the USA has over 5,000 commercial banks[5] and greater dependency on cheques and cash in the financial system than Australia[6]. Australian banks have also continued to invest in transforming branch networks to improve customer service as customer needs have evolved. For example, Commonwealth Bank invested in 226 new format branch locations in FY17.

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[1] Boston Consulting Group, 2016, Retail Banking Excellence Benchmark

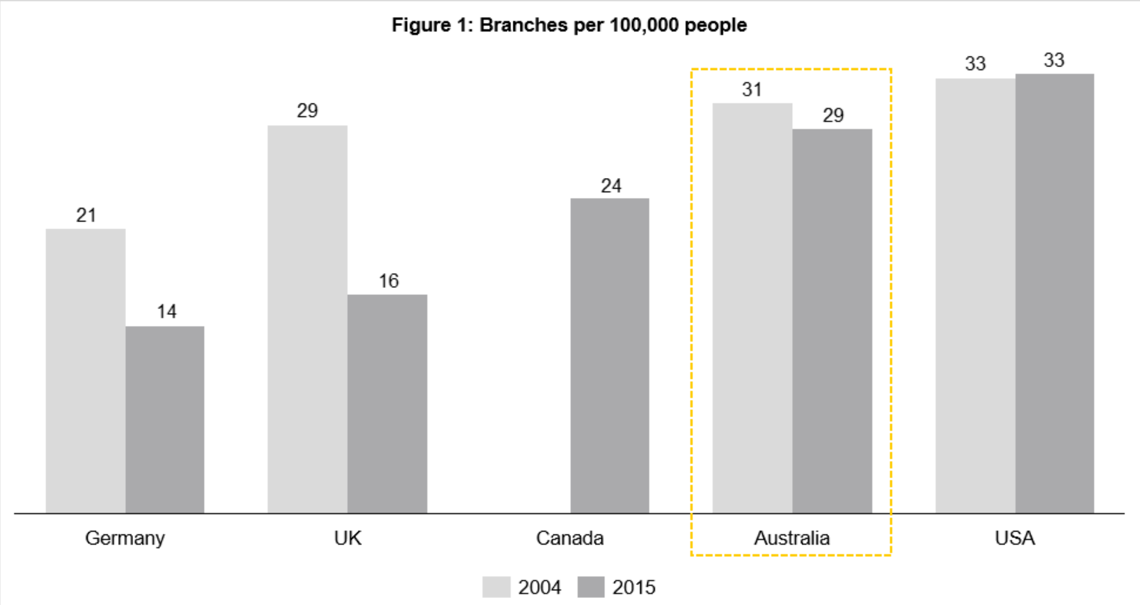
[2] CommBank app on iOS and Android in Australia. Ranking Sources: Apple App Store, Google Play Store

[3] Global Mobile Banking Benchmark, 2017, Forrester Research, Inc., July 13, 2017

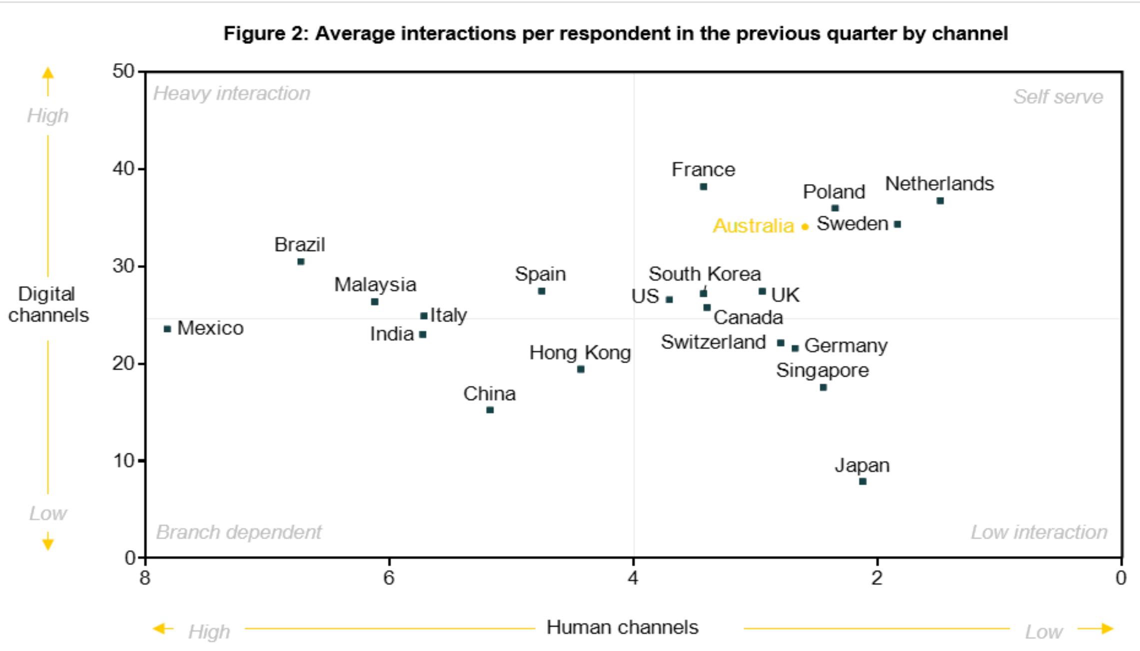
[4] Canadian branch data not available for 2004. International Monetary Fund, 2016, Database: Financial Access Survey, available online at: http://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C

[5] International Monetary Fund, 2016, Database: Financial Access Survey, available online at: http://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C

[6] Volume of cheque transaction in the USA in 2015 was 12,287 million compared to 140 million in Australia during the same year. Bank of International Settlements, 2016, Statistics on payment, clearing and settlement systems in the CPMI countries, available online at: http://www.bis.org/cpmi/publ/d155.htm



While Australian consumers have continued to be able to bank through physical channels if they prefer, they have also benefitted from the development of digital channels (refer to Figure 2[7]). Australian banks have led in developing self-serve banking models enabling customers to interact frequently, with the majority of interactions through digital channels.



Australian banks are highly innovative

Commonwealth Bank believes that competitors in the Australian financial system have demonstrated a deep commitment to innovation, and as a result, have delivered superior, in many cases world-leading, solutions for customers.

[7] Bain/Research Now Retail Banking NPS Survey, 2016, Note: Digital channels exclude ATM

Australian customers have benefited from global firsts in innovation including BPAY[8], which was launched in 1997 as a single bill payment service across the industry, and PEXA, the world's first[9] digital settlement platform enabling digital registration and lodgement of property titles and real-time financial settlement. The first settlement occurred between Commonwealth Bank and Land Victoria in June 2013.

Examples of leading innovations delivered by Commonwealth Bank include:

- Being the first of Australia's Major Banks to invest in a Core Banking Modernisation upgrade. This has enabled Commonwealth Bank to offer real-time banking to customers 24 hours a day, 7 days a week. This foundation has led to over 15 million customers using real-time banking and 40 million digital logons per week by consumers to the CommBank app and NetBank web interface.
- Extending functionality available through the CommBank app to include Camera Pay, Photo-a-bill, Instant Receipts, SavingsJar and SpendTracker. These functionalities are free for all customers and are part of Commonwealth Bank's commitment to helping customers enhance and secure their financial wellbeing. Some of these solutions were co-designed with customers through Commonwealth Bank's Innovation Lab.
- Launching Australia's first 'cardless cash' service in April 2014, enabling customers to use a smart phone app to withdraw cash without a card at Commonwealth Bank's national ATM network. As at 30 June 2017, consumers have made more than 17 million 'cardless cash' transactions.
- Being the first Australian bank to introduce the 'Lock, Block and Limit' facility for credit card customers, allowing them to track and control their spending online and via the CommBank app. The facility allows customers to lock certain transaction types (such as international transactions), block an entire category of transactions (such as ATM cash advances) and set a spending limit per transaction as well as an overall spending cap.
- Being the first bank globally to offer MasterCard® PayPass™ payments capabilities via Near Field Communication technology enabled mobile devices (in partnership with Samsung and MasterCard).
- Investing in Commonwealth Bank's Simple Business Overdraft (up to $50,000) to improve small to medium enterprise ("SME") lending by enabling borrowers to originate an overdraft online or in branch in under 10 minutes and have money funded on the same day.
- Launching Daily IQ 2.0 in April 2017 to provide business insights to SME clients through CommBiz and NetBank. Daily IQ helps clients to optimise cash flow, enhance performance and grow number of customers.

The scale of Australia's Major Banks has enabled them to make significant scale investments for the long term, for example:

- Australia's Major Banks have made substantial investments in sustainability and corporate responsibility. In 2016 Commonwealth Bank ranked 4th in the world in the Global 100 Sustainability Index[10], making it the highest ranking Australian company and the highest

[8] BPAY, 2015, A world first, available online at: http://www.bpay.com.au/About-BPAY/Overview.aspx

[9] PEXA, 2017, CBA Group celebrates 100,000 PEXA transactions, available online at: https://community.pexa.com.au/t5/Share-your-Experiences/CBA-Group-celebrates-100-000-PEXA-transactions/td-p/4337

[10] The Global 100 Sustainability Index (G100) considers a broad range of sustainable business factors including how organisations balance environmental, social, and governance performance while delivering superior returns to investors.

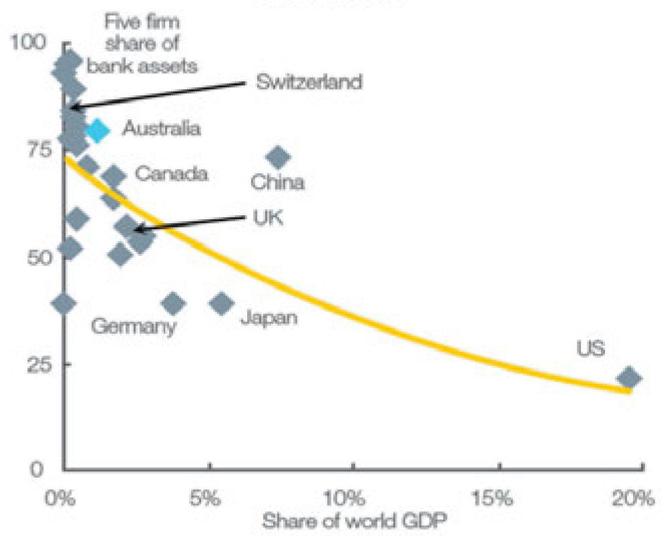
ranking bank in the index. In 2016 Westpac retained its position as the most sustainable bank globally in the Dow Jones Sustainability Indices[11].

- Together with the University of NSW ("UNSW"), Telstra Corporation and the Australian Government ("Government"), Commonwealth Bank is funding research into developing the world's first silicon-based quantum computer.
- Commonwealth Bank is collaborating with Stockland, the University of Technology Sydney and the Australian Technology Network of Universities to explore applications of social robotics, with the ultimate goal of enhancing customer experiences.
- Commonwealth Bank and Westpac are part of R3, a consortium of global banks that has invested in blockchain technology. In October 2016, Commonwealth Bank and Wells Fargo executed the world's first global trade transaction between two independent banks for a shipment of cotton from Texas to Qingdao.
- Commonwealth Bank recently executed a world first by issuing a government bond using blockchain with Queensland Treasury Corporation.

Industry concentration and structure is similar to comparable countries

Concentration levels in Australia are comparable to other relevant countries, particularly when compared to the size of the economy. As the Reserve Bank of Australia ("RBA") has noted, Australia is by no means unique when it comes to the concentration of the banking sector[12]. Among advanced economies, the market share of the largest five banks is comparable to that of Netherlands, Sweden and Canada[13]. By global standards, the level of concentration is consistent with the size of the economy (refer to Figure 3[14]).

Figure 3: Relationship between financial system concentration and economic size



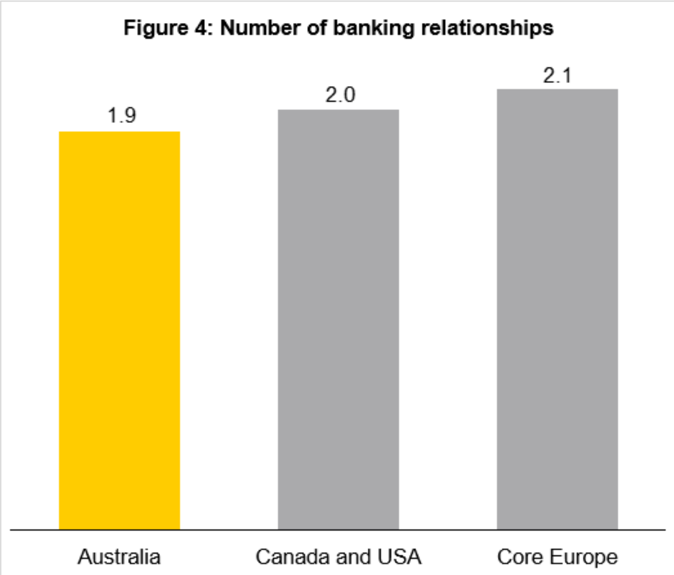
[11] Westpac, 2016, Westpac ranked world's most sustainable bank for the ninth time in 2016 Dow Jones Sustainability Index, available online at: https://www.westpac.com.au/about-westpac/media/media-releases/2016/8-sept/

[12] Bullock, M., 2017, Big banks and financial stability, delivered 21 July, available online: https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html

[13] Bullock, M., 2017, Big banks and financial stability, delivered 21 July, available online: https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html

[14] Liu & Mirzaei, 2013, Industrial growth: Does bank competition, concentration and stability constraint matter?, Brunel University WP 13-23

As seen in Figure 4[15], Australian consumers have a similar number of banking relationships as consumers in peer markets, even in markets which have a significantly higher number of banks.



The Australian financial system includes vertically integrated banks that are typical in the financial systems of many countries. Integrated banks provide significant benefit to customers by enabling them to easily access a broad range of financial products and services to meet their needs at every stage of their lives, and benefit from the distribution network, efficiency and innovation that scale brings. Commonwealth Bank offers customers stability and protection, with capacity to invest in risk management, cyber security and service innovation at scale.

The financial system has matured and has robust Future of Financial Advice ("FOFA") legislation. This applies equally to all participants, affords real customer protection, including the best interests duty and prohibitions on the payment of conflicted remuneration. Commonwealth Bank also maintains comprehensive policies and procedures for identifying, assessing and managing any conflicts of interest that arise as a consequence of being vertically integrated.

There is a high degree of competition and customer choice

New market entrants and emerging business models have contributed to today's highly competitive financial services sector with numerous, diverse providers. In addition to Australia's Major Banks, customers can choose to meet their financial service needs through regional banks, credit unions and mutuals, non-bank lenders, non-financial consumer brands (for example, Qantas, Coles) as well as a growing range of global technology businesses (for example, PayPal, AliPay) and FinTechs.

Competitive intensity in the Australian financial system is high as can be evidenced by the direct marketing spend per customer of Australia's Major Banks which is on par with global peers[16].

[15] McKinsey, 2016, Retail Banking Consumer Survey; Australia Personal Financial Services Survey 2014
[16] Boston Consulting Group, 2016, Retail Banking Excellence Benchmark, Australia's Major Banks median spend compared to global median spend

The rise of online comparison websites makes it easier for consumers to compare products and offers across providers. In addition, changes to the National Consumer Credit Protection Act (2009) have made it mandatory for all providers to provide a key facts sheet outlining important pricing information to customers when they apply for a credit card or home loan.

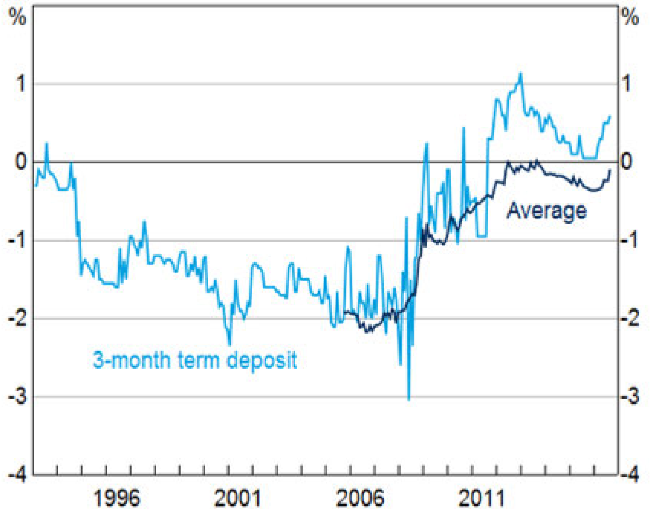
Furthermore, the introduction of an Open Banking framework, currently being reviewed by Treasury, will give customers greater power to compare price and service offerings of different providers.

Deposits

Australia has 152 Authorised Deposit-taking Institutions ("ADIs")[17] (of which 108 are authorised to take household deposits) and this number is expected to continue growing as APRA lowers licensing hurdles. The number of banks that held household deposit balances increased by 43 percent from June 2012 to June 2017[18].

Since the Global Financial Crisis ("GFC"), and the introduction of Basel III, Australian banks have been particularly focussed on competing for domestic deposits and term deposits, as banks have reoriented their sources of funding[19]. As the RBA has noted, average interest rates on deposits have increased by around 2 percentage points relative to the cash rate since 2007[20], reflecting this increased competition (refer to Figure 5[21]).

Figure 5: Deposit interest rates spread to the cash rate



[17] Australian Prudential Regulation Authority, 2017, List of Authorised Deposit-taking Institutions (ADIs), available online at: http://www.apra.gov.au/adi/pages/adilist.aspx

[18] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx

[19] Reserve Bank of Australia, 2017, Developments in banks' funding costs and lending Rates, available online at: https://www.rba.gov.au/publications/bulletin/2017/mar/pdf/bu-0317-5-developments-in-banks-funding-costs-and-lending-rates.pdf

[20] Reserve Bank of Australia, 2016, Submission to the House of Representatives Standing Committee on Economics, available online at: http://www.rba.gov.au/publications/submissions/bank-fees-and-margins/handout-standing-committee-on-economics-2016-09-22/

[21] Reserve Bank of Australia, 2016, Submission to the House of Representatives Standing Committee on Economics, available online at: http://www.rba.gov.au/publications/submissions/bank-fees-and-margins/handout-standing-committee-on-economics-2016-09-22/ (underlying sources: APRA; Canstar; Major banks; RBA)

Payments, credit cards and personal credit

For payments, competition has intensified as large consumer franchises such as PayPal, AliPay, Apple, other multinational technology firms and smaller FinTech companies compete in the financial system. For example, Apple announced the launch of a virtual Apple Pay prepaid card, which can be used with merchants which accept Apple Pay and which can also send peer-to-peer payments via Apple's iMessage service. Facebook has also recently secured a patent in relation to executing payments via its Messenger service. The increase in the number of service offerings is particularly evident in credit cards where there are now approximately 100 credit card brands offering over 250 credit card products in Australia[22].

In personal lending, Australia's Major Banks make up less than 50 percent [23] of the market, competing against an increasing number of regulated competitors and shadow banking competitors[24]. Today there are 73 banks lending to non-financial corporations, an increase from 61 in 2014[25]. In addition, more than 19 FinTechs[26] are engaged in lending to small to medium enterprises.

Mortgages

Competition in the Australian mortgage market is intense, with refinancing making up 36 percent[27] of the volume of all new owner occupied housing finance commitments in 2016.

Competition is in part facilitated by the role of mortgage brokers. For example, Australian Finance Group has 2,875 mortgage brokers across Australia who have access to more than 3,400 products from 45 lenders[28]. With over 16,000 residential mortgage brokers active in the industry[29], the volume of mortgages originated by brokers has increased from 47.7 percent in 2012 to 54.3 percent in 2015[30].

There has been rapid growth in the less regulated shadow banking sector for mortgages as consumers increasingly turn to non-bank lenders to obtain financing, partly driven by APRA applying macro prudential caps on interest-only and investor lending.

Corporate and institutional banking

Competition in the corporate and institutional lending market in Australia is strong with a number of international banks entering or re-entering the market, in particular Asian banks increasing their presence in Australia. This is leading to significant liquidity in the local market. Institutional investors are also now becoming a realistic option for borrowers, particularly where they are seeking longer

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[22] Treasury Ministerial Brief, 2015, Credit card interest rates

[23] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx, Reserve Bank of Australia, 2017, RBA Lending and Credit Aggregates Data

[24] The Financial Stability Board (FSB) defines shadow banking as credit intermediation involving entities and activities (fully or partially) outside the regular banking system

[25] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx

[26] Fintech Australia, 2017, Fintech member ecosystem map, available online at: https://fintechaustralia.org.au/fintech-australia-releases-fintech-ecosystem-map/

[27] Australian Bureau of Statistics, 2017, Housing finance commitments (owner occupation), available online at: http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5609.0June%202017?OpenDocument

[28] Australian Finance Group, 2017, Annual results for 2017, http://www.afgonline.com.au/news/australian-finance-group-annual-results-for-2017

[29] MFAA, 2017, About our industry, available online at: https://www.mfaa.com.au/our-industry/about (accessed

[30] Australian Securities & Investments Commission, 2017, Review of mortgage broker remuneration, available online at: http://download.asic.gov.au/media/4184768/rep516-published-16-3-2017.pdf

tenor (5 years +) borrowings. This combined with increasing capital costs for Australia's Major Banks is resulting in greater price competition for Australian banks and reduced market share of the corporate and institutional banking segment. Australia's Major Banks are now experiencing a number of corporate loan facilities below breakeven, and are exiting certain clients as a result.

The Australian dollar is one of the most traded and liquid currencies in the world, making up 7 percent of global foreign exchange turnover. The Australian foreign exchange market enjoys strong participation of overseas financial institutions, which make up 77 percent of total turnover[31]. In the Australian fixed income markets, 18 registered banks make tight markets in Treasury Bonds and Treasury Indexed Bonds[32]. The SYCOM (ASX Trade24) trading system permits near-24 hour trading of ASX's futures contracts, and Australian government bonds have two-way market liquidity on a 24 hour basis. Liquidity in bond futures is at an all-time high. While there has been some retreat of offshore market makers from Australian fixed income markets, competition continues to be robust as overall capital allocated to trading activities has remained relatively stable post-GFC. This is in contrast to overseas markets, which have witnessed dramatic declines in market making capacity[33].

Overall over-the-counter ("OTC") derivatives trading in Australia have declined slightly in recent years, as a growing share of contracts denominated in Australian dollars are being traded in other major financial centres[34]. Nevertheless, Australia remains the 5th largest centre of derivatives trading, while the Australian dollar is the 5th most traded currency denomination in the interest rate derivatives market.

In recent years, Government has taken further measures to increase competition in financial markets. These measures include transferring supervision of Australia's equities markets to ASIC and amending regulatory arrangements to allow the entry of Chi-X Australia in the equities trading market. Australia is implementing the global regulatory reform agenda, including derivatives reform, in line with other jurisdictions across the globe.

Nevertheless, uneven implementation of Basel reforms has at times skewed the environment in favour of offshore competitors. For example, the Net Stable Funding Ratio ("NSFR") will take effect in Australia in January 2018, in line with the Basel timeline. The majority of other jurisdictions have postponed its implementation, or are proposing meaningful changes in order to limit its market impact. In addition, credit value adjustment ("CVA") calculations can be relatively more onerous, as APRA requires banks to use the "standardised" or the "simplified" approach to determine CVA risk capital charges. This contrasts with the less capital intensive "advanced" approach. Competitive pressures on derivatives pricing are compounded by the fact some overseas jurisdictions do not require CVA capital on corporate derivatives trades, or do not require CVA regulatory capital at all.

New entrants to the Australian market in recent years

The Australian FinTech industry has seen record investment of $656 million in 2016, up from $185 million and $461 million in 2015 and 2014 respectively[35]. As discussed further in Chapter 3, low competition hurdles in the financial system have encouraged new entrants. The number of Sydney-

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[31] Bank for International Settlements, 2016, Triennial Central Bank Survey, OTC interest rate derivatives Turnover in April 2016

[32] Australian Government Securities Secondary market participants

[33] Reserve Bank of Australia, 2016, Liquidity in fixed income markets, available online at: https://www.rba.gov.au/publications/bulletin/2016/jun/7.html

[34] Bank for International Settlements, 2016, Triennial Central Bank Survey, OTC interest rate derivatives Turnover in April 2016

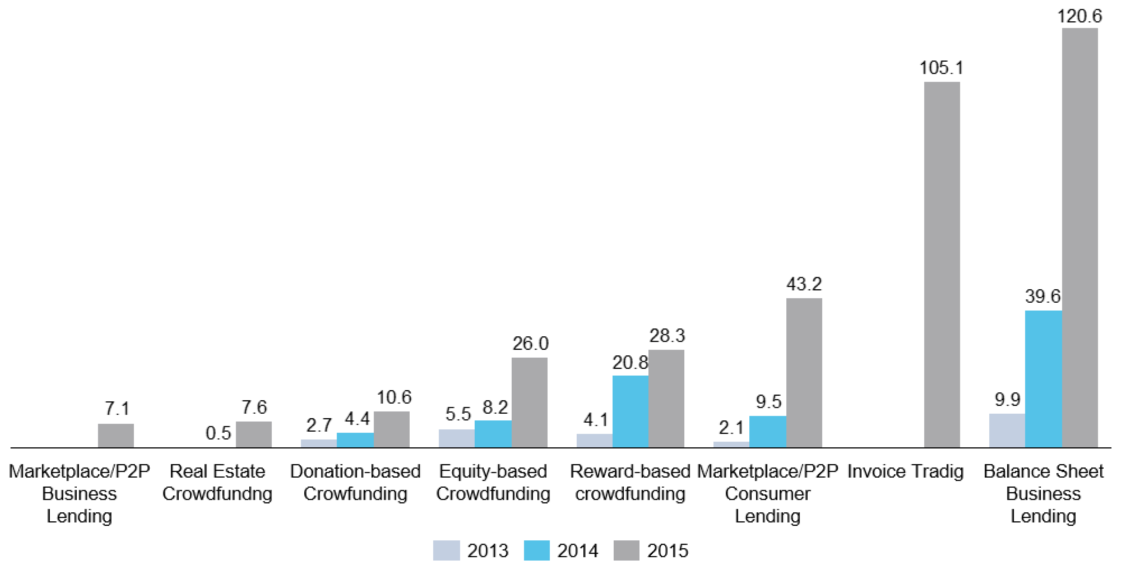
[35] KPMG, 2017, US$656 million invested in Australia's fintech sector in 2016, available online at: https://home.kpmg.com/au/en/home/media/press-releases/2017/02/fintech-pulse-q4-2016-23-feb-2017.html

based FinTechs has grown from under 100 in 2014 to 579 in 2017, employing more than 10,000 staff[36]. In addition to FinTechs, a number of global technology organisations and other large organisations have entered the financial system in recent years.

Examples of the range of new competitors participating in the Australian financial system in recent years include:

- Deposits: 29 banking licenses issued in the last 10 years, including Fintech Tyro Payments[37].
- Payments: New digital wallets, entry of AliPay, PayPal, UnionPay, ApplePay and AndroidPay.
- Credit cards and personal credit: Entry of deferred payment providers such as AfterPay and Zipmoney; new credit cards introduced from non-financial services competitors such as Qantas, Woolworths and Coles after regulation changed in 2015; non-banking, asset financing providers such as GE Money, Nimble, SocietyOne.
- Mortgages: FinTechs such as Tic Toc which offers “instant home loans” and peer lending for real estate platform Peer Estate, as well as the entry of mortgage bidding platforms such as LoanDolphin and Joust.
- SME and business lending: Rise of shadow banking lending businesses such as SocietyOne; OnDeck; PayPal offering finance to small businesses; and other SME targeting lenders. Figure 6[38] reflects growth in alternative financing.
- Merchant services: New offerings such as Stripe, Square, AfterPay.
- Corporate and institutional lending: Global banks re-entering market, for example, 23 percent increase in corporate lending[39] by Chinese banks in Australia over the past year.

Figure 6: Growth in the Australian alternative finance market (volume $USD millions)



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[36] KPMG and The Committee for Sydney, 2017, Scaling the fintech opportunity for Sydney and Australia, available online at: https://home.kpmg.com/au/en/home/insights/2017/08/scaling-fintech-opportunity-sydney-australia.html

[37] Tyro Payments, 2015, Tyro Payments secures $100 million in funding, available online at: https://www.tyro.com/press-releases/tyro-payments-secures-100-million-in-funding/

[38] KPMG and The Committee for Sydney, 2017, Scaling the fintech opportunity for Sydney and Australia, available online at: https://home.kpmg.com/au/en/home/insights/2017/08/scaling-fintech-opportunity-sydney-australia.html

[39] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx

In recent years, Australia's banks have pro-actively partnered with new market entrants. New entrants provide talent and innovative ideas while established banks offer mature processes as well as access to distribution channels.

Examples of partnerships in the banking sector include Commonwealth Bank's partnership with OnDeck. Commenced in December 2015, the pilot collaboration serviced the bank's retail SME customers with revenue under $1 million looking for short-term, unsecured loans based on a range of credit information. The partnership was awarded FinTech-Bank Collaboration of the Year at the 2016 Australian FinTech Awards. Another example is Sydney FinTech Kounta, which has partnered with Commonwealth Bank to integrate its payment and point-of-sale app into the bank's Albert EFTPOS tablet.

Other examples of successful partnerships between banks and new entrants include the broad industry support of FinTech hub Stone & Chalk.

Enabling customers to make informed choice

The number of products and product providers has increased as a result of intense competition across the Australian financial system. Simple, clear product disclosures and transparency around product features, fees, charges and rates assist customers to compare products and make more informed choices. To date, the industry has supported regulatory efforts to modernise the disclosure regime, predominantly driven by ASIC. Industry has also conducted research and implemented its own measures that are designed to improve disclosure and customer engagement. For example, Commonwealth Bank has simplified terms and conditions ("T&Cs") for Transaction, Savings and Investment Accounts, with further enhancements in-train for Home Lending products. Commonwealth Bank recently introduced proactive communications to customers to highlight fixed rate home loan maturities, expiry of honeymoon rates and line of credit repayments. As a result of such efforts, customers are able to make more informed decisions and further harness the benefits of Australia's competitive market.

Customer satisfaction levels are high

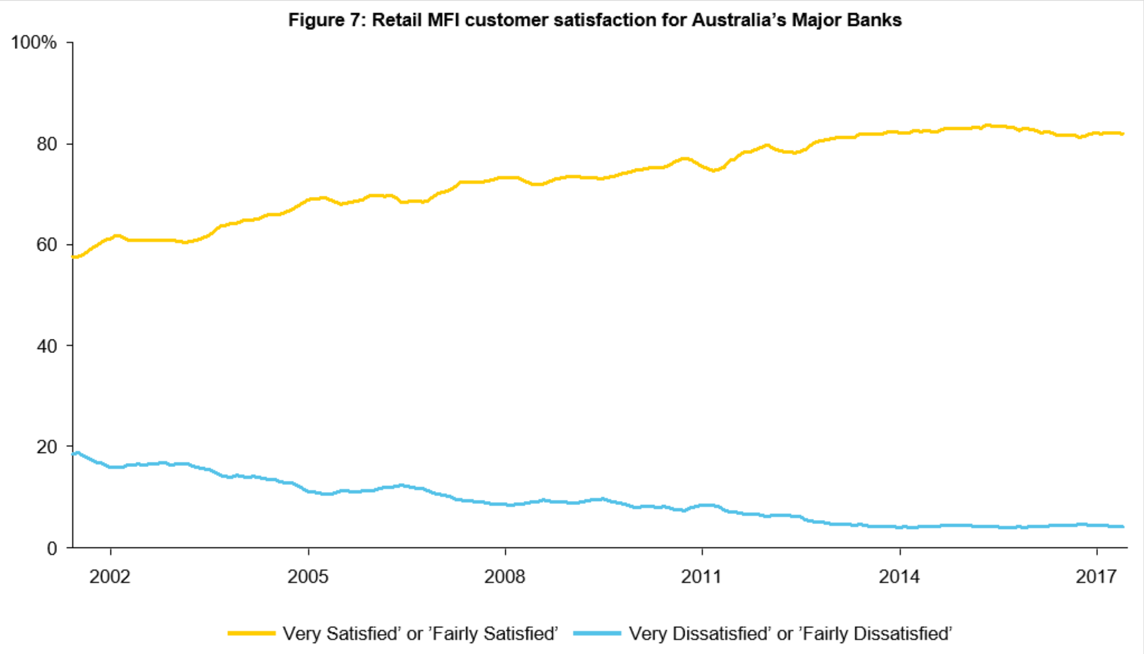
As a result of the ever increasing range of value propositions and innovations available to consumers, customer satisfaction is high, and has been increasing (refer to Figure 7[40]). This has corresponded with declining customer dissatisfaction (refer to Figure 7).

For example, in the 16 years to June 2017, the proportion of respondents in Roy Morgan's Retail Main Financial Institution ("MFI") Customer Satisfaction survey who said they were "Very Satisfied" or "Fairly Satisfied" with their MFI has increased from 57.6 percent to 81.8 percent, with the proportion of dissatisfied respondents decreasing from 18.6 percent to 4.1 percent[41].

[40] Roy Morgan Research, Retail Main Financial Institution (MFI) Customer Satisfaction, Australian population 14 years+, 6 month rolling average to June 2017. Australia's Major Banks include ANZ, CBA excluding Bankwest, NAB and Westpac excluding St, George Group. Satisfaction includes percent "very satisfied" or "fairly satisfied" with relationship with MFI and Dissatisfaction includes percent "very dissatisfied" or "fairly dissatisfied" with relationship with MFI

[41] Roy Morgan Research, Retail Main Financial Institution (MFI) Customer Satisfaction, Australian population 14 years+, 6 month rolling average to June 2017. Australia's Major Banks include ANZ, CBA excluding Bankwest, NAB and Westpac excluding St, George Group. Satisfaction includes percent "very satisfied" or "fairly satisfied" with relationship with MFI and Dissatisfaction includes percent "very dissatisfied" or "fairly dissatisfied" with relationship with MFI

Similarly, in the 7 years to June 2017, the proportion of business customers satisfied with their MFI increased by 2.6 percent with the proportion of dissatisfied customers decreasing by 2.3 percent[42].



The Australian financial system is productive

The intensity of competition in Australia's financial system has created incentives for Australian banks to become more productive.

Australian banks are among the most efficient banks in the world, having a lower cost-to-income ratio, lower cost-to-asset ratio and lower operating expenses per customer[43] than in most comparable countries (refer to Figures 8[44] and 9[45]). This reflects ongoing investment in technology which boosts productivity as well as improving customer service levels and outcomes.

The productivity of Australian banks has also benefited customers through lower financial transaction costs as a percentage of gross domestic product ("GDP"), as shown in Figure 10[46].

[42] DBM Business Financial Services Monitor, 2017, Satisfaction with MFI, percentage of respondents who scored 0-4 and 6-10. Selected MFIs comprise only of Australia's Major Banks including ANZ, NAB, Westpac, and CBA excluding Bankwest, and Regional Banks including Bendigo Bank, Bank of
Queensland, Suncorp

[43] Boston Consulting Group, 2016, Retail Banking Excellence Benchmark (Australia's Major Banks have lower operating expenses per customer compared to the global median)

[44] Bullock, M., 2017, Big banks and financial stability, delivered 21 July, available online: https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html (underlying source of graph: RBA; S&P Global Market Intelligence) Market share of the five largest banks

[45]Cost-to-Assets calculated as sum of Total Non-Interest Expenses divided by sum of Total Assets for Primary Banks in each country (Diversified Financials excluded). S&P Capital IQ, PwC Analysis

[46] Reserve Bank of Australia, 2017, Domestic banking fee income, available online at: http://www.rba.gov.au/statistics/tables/, Australian Bureau of Statistics, 2016, Gross domestic product: Current prices

Figure 8: Large banks' cost-to-income ratios (%)

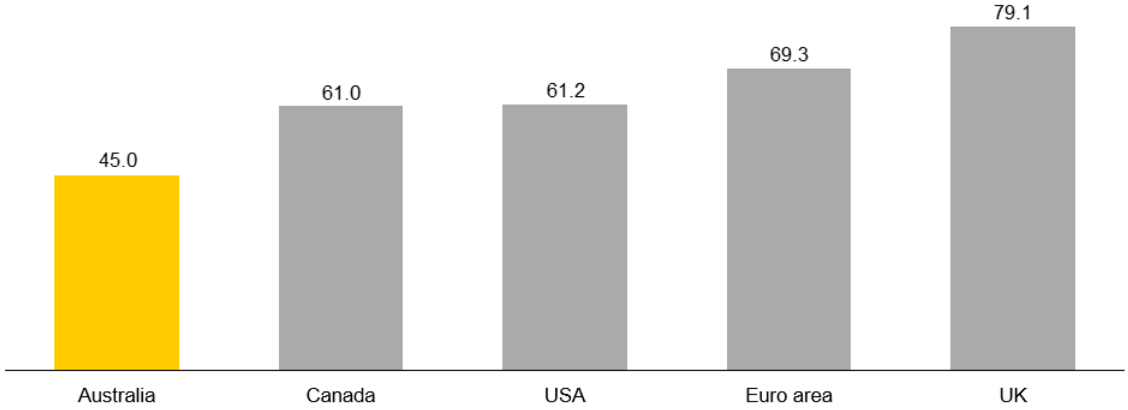


Figure 9: Banks' cost-to-asset ratios (%)

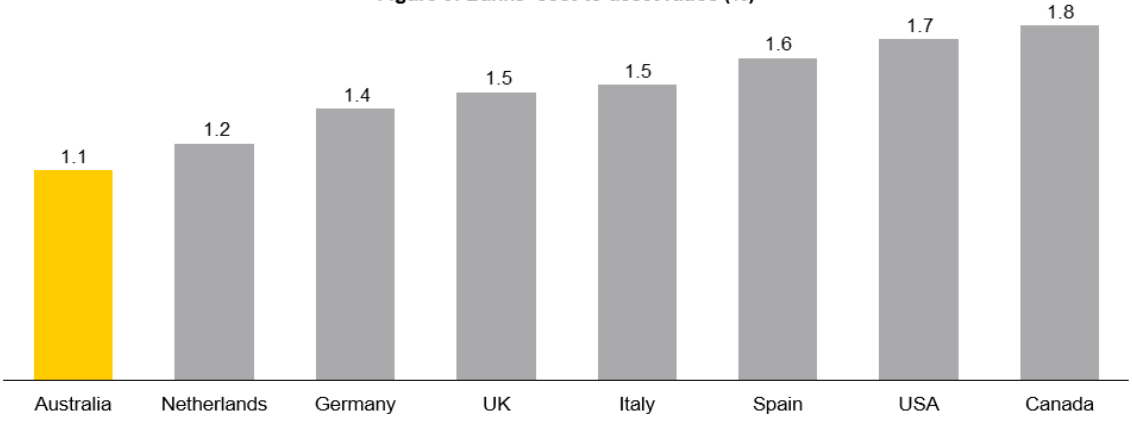
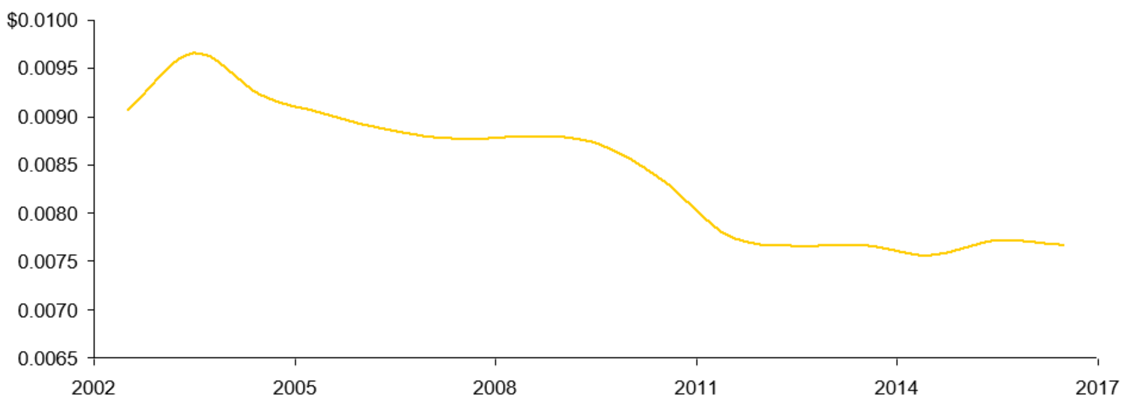


Figure 10: Bank fees per dollar of GDP



Chapter 2: Strong, stable banks underpinning prosperity and sustainable growth

Summary

The Australian economy has enjoyed an unprecedented period of economic growth. The performance of banks relative to the overall economy is typical pro-cyclical in nature. The result is that firms in the financial sector have generally also performed strongly, thus ensuring financial system stability and ongoing investment in improving customer outcomes against a backdrop of global economic uncertainty. Prudent risk taking by banks has contributed to ongoing stability.

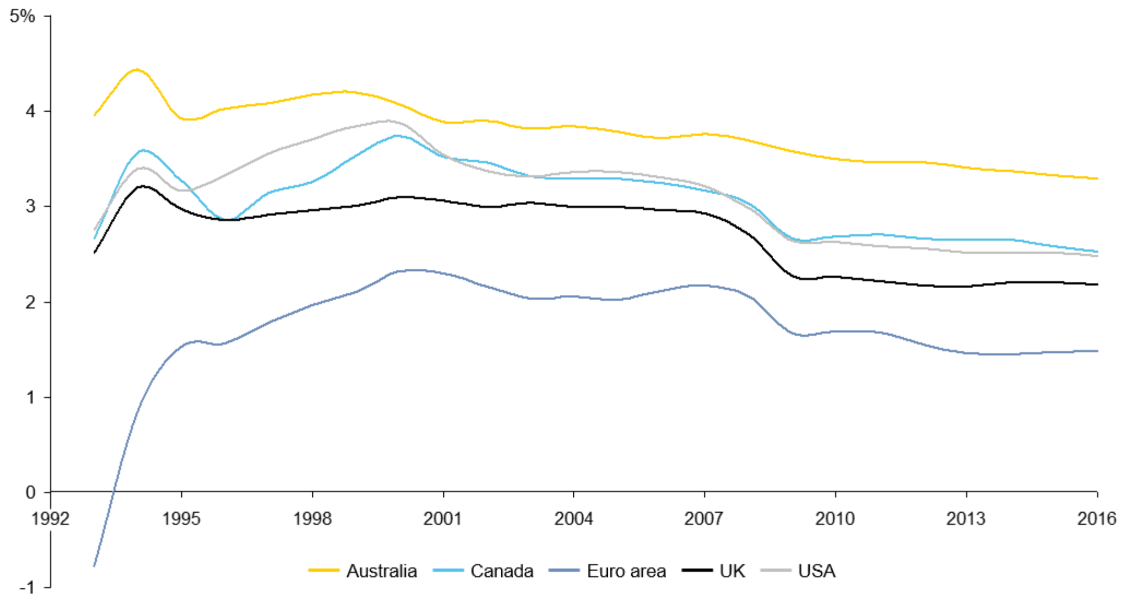
Australia's Major Banks facilitate universal access to banking for Australian customers and fund sustainable economic growth for the broader economy. Large and stable banks such as Commonwealth Bank are able to leverage their scale and stability to access global funding at effective rates to fund Australia's current account deficit. Scale also enables banks to make important contributions to society through investments in widely-distributed branch and digital networks as well as services to promote financial literacy and wellbeing across communities.

The importance of stability should not be underestimated, as financial system instability can have significant consequences on the broader economy.

Australia has enjoyed an unprecedented period of economic growth and stability

The Australian economy has benefited from over twenty years of annual economic growth (see Figure 11[47]), outpacing the majority of comparable economies.

Figure 11: Real GDP CAGR



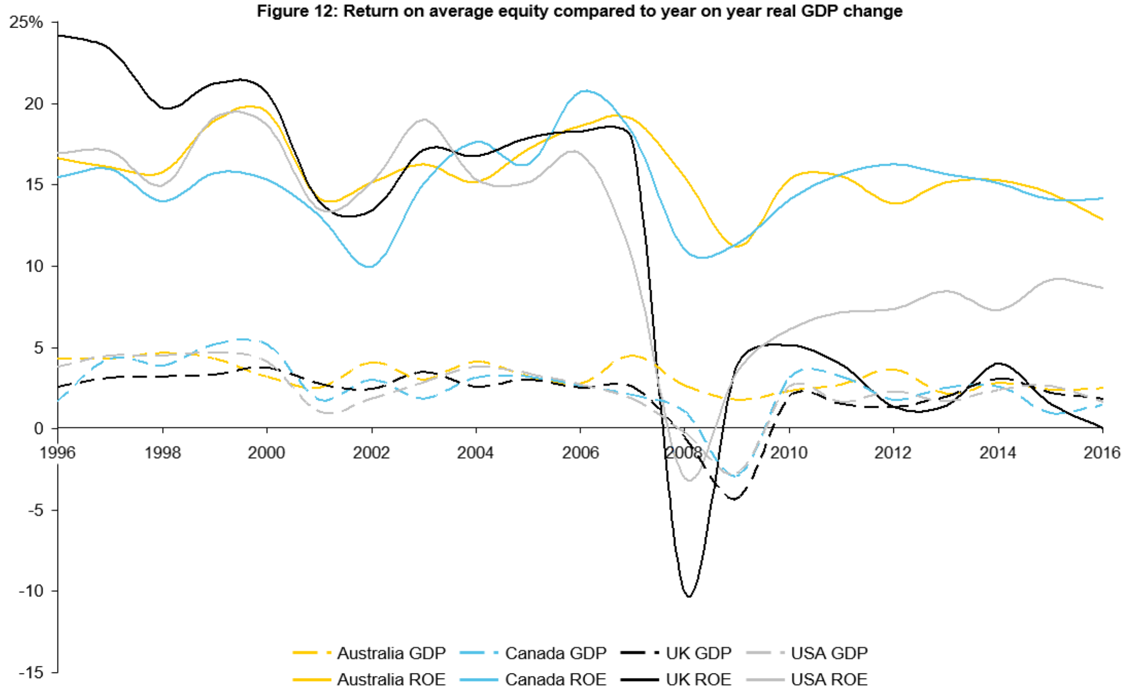
[47] International Monetary Fund, 2017, Database: World Economic Outlook, available online at: https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx

Sustained economic growth has combined with strong regulatory and prudential oversight to deliver a strong and stable financial system. In turn, the stability and strength of the financial system has reinforced economic strength by providing access to capital at effective rates to fund growth of the Australian economy and facilitate universal access to banking for all Australian customers.

Pro-cyclicality has upheld strong performance in the Australian financial system

Banking industry returns, as measured by returns on equity ("ROE"), are closely linked to macro-economic conditions. As such, the returns of Australian banks have generally outperformed global peers as the Australian economy has performed strongly, against a backdrop of global volatility and off-shore banks operating in challenging economic conditions. The resilience of the Australian economy and the Australian banking sector was demonstrated during the most recent global economic downturn (refer to Figure 12[48]).

Figure 12: Return on average equity compared to year on year real GDP change



During this period, the Australian economy continued to prosper. At the same time, Australian banks made significant investments in technology and customer service, reduced operating costs (taking into consideration the impact on customers and employees) and utilised capital more efficiently in response to evolving prudential requirements (refer to Chapter 3 for further detail).

In contrast, during the same period, several global banks were impacted by economic instability in the following ways:

- Certain banks were hampered by funding models and lost market share (for example, in order to reduce funding pressure on its balance sheet, HBOS sold Bankwest at a loss of £0.8 billion)[49].

[48] FactSet, 2017, Database: Return on average equity. Banks included in analysis: Australia (CBA, ANZ, NAB, WBC), Canada (CIBC, BMO, RBC, TD, Scotiabank), UK (StanChart, HSBC, RBS, Barclays, Lloyds), USA (JPM, Citi, Wells Fargo, BoA, USBancorp, PNC, CapitalOne)
[49] Financial Conduct Authority, 2015, The failure of HBOS plc, available online at: 'http://www.bankofengland.co.uk/pra/Documents/publications/reports/hbos.pdf

- Internationally, many banks implemented cost cutting programs to recover from the GFC, which led to negative impacts on customer service and staff, such as reduction of core services. For instance, in the UK branches per 100,000 people decreased from 29 in 2004 to 16 in 2015[50], whereas in Australia the figure over the same period fell from 31 to 29[51].

In the same period, Australian banks demonstrated strength as foreign banks retreated from the Australian market:

- As access to funding became scarce, foreign competitors retreated from the Australian market to focus on core geographies (for example Royal Bank of Scotland and Société Générale).
- Some bank and non-bank lenders which were reliant on Residential Mortgage-Backed Securities ("RMBS") markets for funding exited the Australian mortgage market (for example, Macquarie Bank scaled back its home loan business during the GFC[52], RAMS Home Loans Group was sold to Westpac when RAMS was unable to access alternative sources of funding[53]).

If Australia was to experience a downturn, or growth was to remain at levels below long term averages for a sustained period, this could have a similarly negative impact on the performance of Australian banks. For example, any credit rating downgrades would have a negative impact on long term funding spreads which could lead to higher rates.

Any examination of the performance of the Australian financial sector, and specifically whether current levels of profitability require further regulatory intervention, must take into consideration the sector's performance "through the cycle".

Prudent risk taking by Australian banks has supported financial system stability

Competition in Australia has focused on service, price and innovation within a framework of strong regulatory oversight. The result is that in Australia there has not been competitive "creep" into areas such as the high level of lending in the sub-prime market in the USA prior to the GFC that present structural risks to the sector.

For example, products such as loans with graduated payment schedules (being a mortgage with a fixed rate that begins with low payments and increases according to a defined schedule) were common in the USA. In Australia, banks are required to undertake stringent responsible lending assessments under the National Consumer Credit Protection Act. Consequently Australia's Major Banks have exhibited lower non-performing loan levels than most global peers, refer to Figure 13[54].

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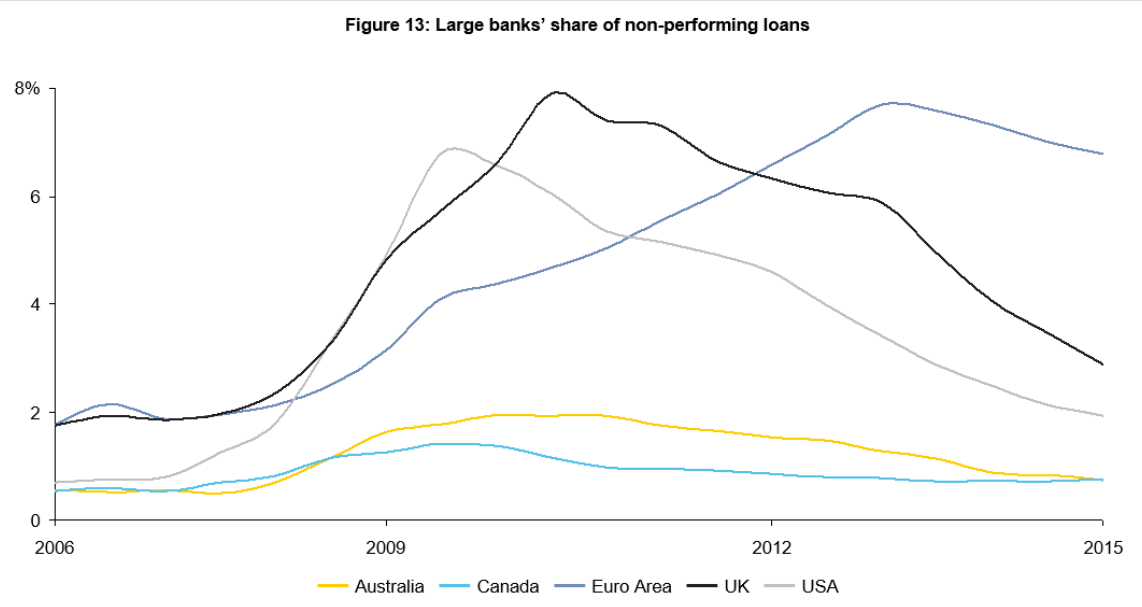
[50] PwC analysis, 2017

[51] World Bank, 2017, Database: Commercial Bank Branches per 100,000 adults, available online at: http://data.worldbank.org/indicator/FB.CBK.BRCH.P5?locations=AU-XD-SE-US

[52] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx

[53] ASX, 2007, RAMS meets its FY07 prospectus forecast and continues to monitor FY08 position, RAMS funding and annual general meeting update, available online at http://www.asx.com.au/asxpdf/20070828/pdf/31466tkbk8gfrh.pdf and http://www.asx.com.au/asxpdf/20071121/pdf/315yjfrz4q67zs.pdf

[54] Reserve Bank of Australia, 2016, Financial stability review, available online at: https://www.rba.gov.au/publications/fsr/2016/apr/pdf/financial-stability-review-2016-04.pdf (underlying source of graph: APRA, Banks' Annual and Interim Reports, Bloomberg, FSA, RBA, SNL Financial)



In the case of lending secured by residential property, Commonwealth Bank and Bankwest use an internal assessment rate that is a minimum of 2.25 percent above the customer interest rate to test ongoing serviceability. The strength of Commonwealth Bank's and Bankwest's lending practices is evidenced by the fact that 77 percent of Commonwealth Bank and Bankwest mortgage customers have made 33 payments in advance (on average) in FY17.

Large, stable banks enable the Australian economy to fund its current account deficit by accessing global capital markets at competitive rates

As noted by the Financial System Inquiry ("FSI"), "the core function of the financial system is to facilitate the funding of sustainable economic growth"[55]. This requires the financial system to have the capacity to support the economy through an economic downturn, even a protracted one. In a financial system with strong regulatory settings where the requirement is to be "unquestionably strong", banks sustainably meeting their cost of capital is critical.

The ability of large Australian banks with strong credit ratings to access funding markets at competitive borrowing rates is critical to the Australian economy and to fund Australia's current account deficit, both in normal and stressed macro-economic conditions.

Capital access has been critical to funding Australian households and businesses as well as the current account deficit. As shown in Figure 14[56] the contribution of Australian banks to facilitating the growth of the Australian economy is higher than in comparable countries. Australian banks finance growth through a combination of domestic and foreign, deposit and wholesale funding (refer to Figure 15[57]). Approximately 70 per cent[58] of Australian bond issuance offshore.

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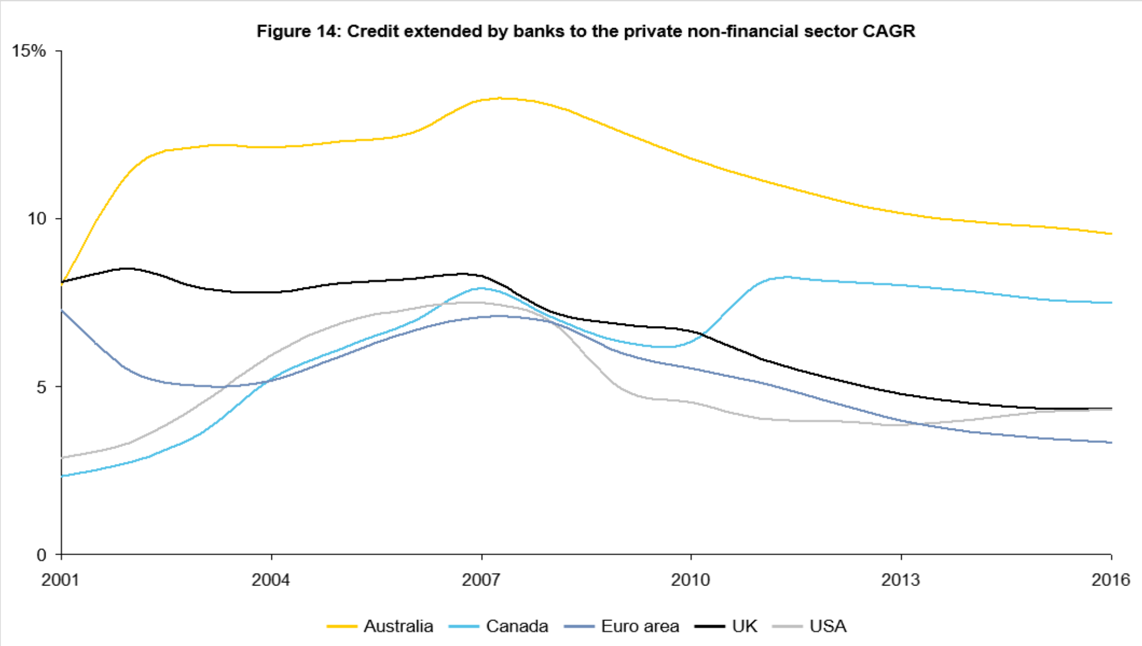
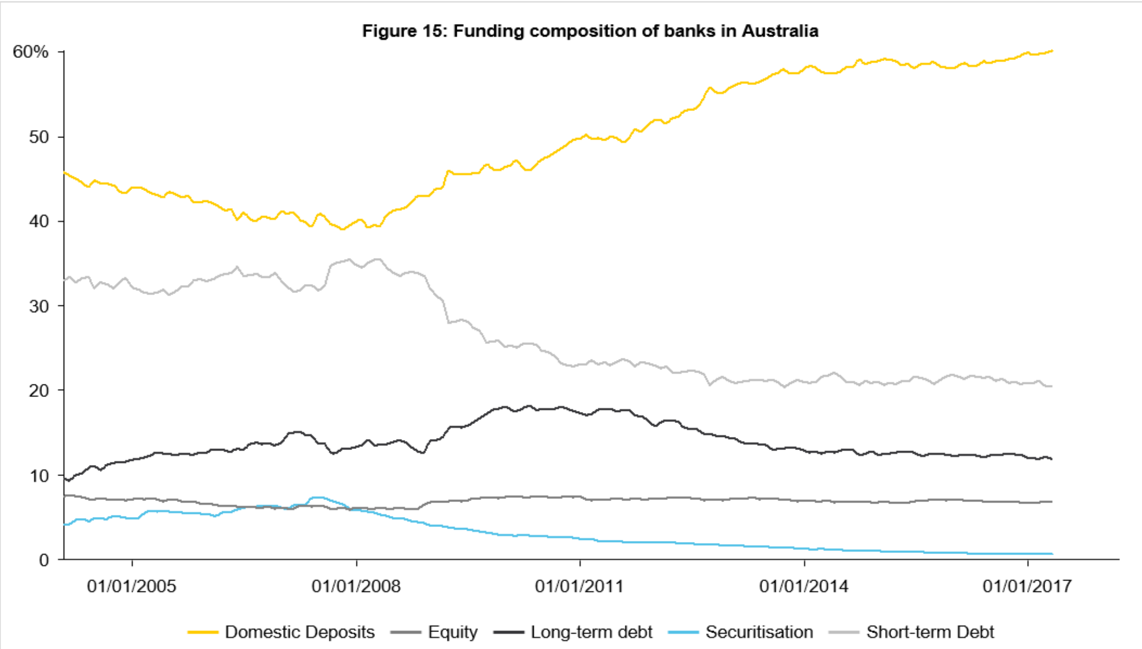
[55] Murray, D., 2014, Financial system inquiry, final report, available online at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf
[56] Bank for International Settlements, June 2017, Database: Credit to the non-financial sector, available online at: http://www.bis.org/statistics/totcredit.htm
[57] Reserve Bank of Australia, 2017, Bulletin, available online at: https://www.rba.gov.au/publications/bulletin/2017/jun/pdf/bu-0617-reserve-bank-bulletin.pdf (underlying sources: APRA; RBA; Standards & Poor's)
[58] Reserve Bank of Australia, 2017, Bulletin, available online at: https://www.rba.gov.au/publications/bulletin/2017/jun/pdf/bu-0617-reserve-bank-bulletin.pdf and Reserve Bank of Australia, 2017, Fixed markets and the economy, available online at: https://www.rba.gov.au/speeches/2017/sp-ag-2017-08-09.html





Access to capital is critical in both normal and stressed macro-economic conditions. For instance, during the GFC, the Government noted:

> *"The regulation and supervision of Australia's institutions is strong, effective and coherent. Australian banks are well capitalised and have limited exposure to the type of sub-prime mortgages that are found in the US and also to the US, UK and European institutions that have faced insolvency during the turbulence of the past year."*[59]

[59] Australian Government, 2008-09, The government's response to the global financial crisis, available online at: http://www.budget.gov.au/2008-09/content/myefo/html/part_2.htm

Post-GFC, Australia's Major Banks continued to support large domestic corporate borrowers in the corporate and institutional banking segment as a number of foreign banks exited the domestic market.

The high capital levels, increasing liquidity buffers and regulatory oversight of Australia's systemically important banks (which APRA defines as Australia's Major Banks) are the bedrock of the financial system's stability and ability to withstand external shocks.

Australia's Major Banks facilitate prosperity through universal access to banking

Financial inclusion is defined as the proportion of adults who have access to useful and affordable financial products and services that meet their needs[60]. The World Bank has identified that access to a transaction account is the first step to achieving broader financial inclusion.

Australia's Major Banks play an important role in supporting financial inclusion by providing affordable banking solutions, including to financially vulnerable people. Large banks have an ability to support vulnerable people by offering universal access to core products and services to all Australian customers and by maintaining extensive physical networks as well as world-leading digital channels.

World Bank data shows that the level of financial inclusion in Australia is higher than in other OECD high income countries. For instance, in 2014, 99 percent of the people in Australia aged 15 or over had an account with a financial institution, compared to 94 percent of people in the USA where the financial system is more fragmented[61]. Furthermore, through investment in financial literacy for customers by large banks, 61 percent of people in Australia aged 15 or over have formal savings, compared to 52 percent on average for OECD high income countries.

Commonwealth Bank and Bankwest maintain 1,121 branches along with 4,398 ATMs supported by 41,600 staff in Australia[62]. Unlike in many other countries, Australian banks have maintained an extensive branch footprint. Commonwealth Bank, for instance, has not significantly reduced its branch footprint in rural and regional Australia in the decade to June 2017[63]. As outlined in Chapter 1, Australia has 29 branches per 100,000 adults compared to an average of 20 branches among OECD high income countries, a figure which has fallen by 15 percent from 2004 to 2015[64].

In addition to affordable basic banking products and extensive physical and digital service channels, Australia's Major Banks support customers in difficulty. Commonwealth Bank's Customer Assistance teams offer medium-term and ongoing financial assistance and support to customers that have experienced financial difficulty and hardship as a result of injury or illness, unemployment, natural disaster, reduction of income or domestic violence. Through these teams, Commonwealth Bank works directly with customers to develop solutions that are tailored to their circumstances. Solutions may include offering relief from existing debt repayment obligations and short-term money management strategies. Commonwealth Bank has continually invested in these capabilities with the aim of supporting financial rehabilitation and long-term financial wellbeing for customers.

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[60] World Bank, 2014, Global Financial Development Report, available online at: http://siteresources.worldbank.org/EXTGLOBALFINREPORT/Resources/8816096-1361888425203/9062080-1364927957721/GFDR-2014_Complete_Report.pdf

[61] World Bank, 2014, Financial Inclusion Data, available online at: http://datatopics.worldbank.org/financialinclusion/country/australia

[62] As reported at 30 June 2017

[63] Commonwealth Bank has reduced 8 branches in rural and regional Australia during the period June 2007 to June 2017, from 349 branches to 341 branches

[64] World Bank, 2017, Database: Commercial Bank Branches per 100,000 adults, available online at: http://data.worldbank.org/indicator/FB.CBK.BRCH.P5?locations=AU-XD-SE-US

In addition to transaction accounts, large banks such as Commonwealth Bank are able to provide a diverse range of services, such as retirement planning and insurance as well as various free tools and guidance materials across all aspects of financial life. Commonwealth Bank is committed to helping all customers to enhance and secure their financial wellbeing.

Through its Customer Advocate function, Commonwealth Bank is working with the community, particularly where specific vulnerabilities have been identified. The team includes a dedicated complaint review function, allowing customers to receive an independent review of their complaint, in addition to their existing rights.

In addition, the Customer Advocate Community Council was recently established, comprising representatives from ~25 organisations covering social policy, community welfare, and issues advocacy, providing a forum to listen to, and seek feedback from, the community.

In November 2016, Commonwealth Bank launched its first Financial Inclusion Action Plan ("FIAP"), in partnership with Good Shepherd Microfinance, the Centre for Social Impact, EY, and the Department of Social Services. FIAP includes 27 actions to foster greater financial inclusion, including waiving monthly account and assisted withdrawal fees on a range of eligible accounts. For example, Commonwealth Bank offers fee waivers for customers under 21, recently arrived migrants, customers receiving the Australian War Veteran, Aged or Disability Pension in their account, or customers relying on over-the counter services because of a disability.

Financial system instability can lead to materially adverse outcomes for the economy

Systemic failures from the absence of "unquestionably strong", well capitalised, profitable banks has led to materially adverse outcomes for the broader economy in other countries, as seen in the following two case studies (Figures 16 and 17).

Figure 16:
Ireland case study

In September 2008, Ireland's government announced a broad state guarantee of domestic retail banks for a period of two years. In December 2008 the Irish government announced plans to inject €2 billion into each of Ireland's two largest banks, Allied Irish Bank ("AIB") and Bank of Ireland ("BoI") and inject €1.5 billion of capital to bail out Anglo Irish Bank ("Anglo"), a commercial lending focused bank. In January 2009, Anglo was nationalised amid fears it would collapse. AIB and BoI also required further Irish government assistance, with the effective nationalisation of AIB in December 2010[65]. The aggregate bank bailout measures eventually cost the Irish government €40 billion[66].The Irish government entered the GFC period with a low level of public debt, however it faced the growing burden of recapitalising Ireland's banks as revenue sources deteriorated dramatically[67]. While banking sector assistance measures provided by respective governments during recent crises (2007-2011) negatively impacted government finances across the board, the impact was particularly strong in Ireland, where it contributed to direct fiscal costs of approximately 40 percent of GDP, and an increase in public debt of over 70 percent of GDP[68].

[65] Reuters, Timeline – Ireland's string of bank bailouts

[66] Hanohan, P, Governor of Central Bank of Ireland, 2015, in comments to Parliamentary Joint Committee Of Inquiry Into The Banking Crisis, available online at: https://inquiries.oireachtas.ie/banking/hearings/patrick-honohan-previous-reports-on-irelands-banking-crisis/

[67] Hanohan, P, Governor of the Central Bank of Ireland, 2012, Money, Macro and Finance Conference, Dublin

[68] IMF, 2015, From banking to sovereign stress'

Figure 17:
UK case study

As the GFC began to impact the UK banking sector, the UK government intervened by providing loans, guarantees and share purchases to the Royal Bank of Scotland, Lloyds Banking Group, Northern Rock Asset Management and Bradford & Bingley, supporting selected insolvent British banks and establishing schemes to restabilise the domestic financial system. Simultaneously, the UK government reduced the Bank Rate to 0.5 percent, at its lower bound[69] and introduced a program of large-scale purchases of public and private assets to force down interest rates right across the yield curve and credit spectrum to further stimulate economic activity. The UK government's overall exposure was over £1.1 trillion at its peak[70]. As at 31 March 2017, the level of UK government support for the UK banking sector still stood at £58 billion[71] despite the fact that some sector-wide schemes have been withdrawn, guarantees have been removed, shareholdings have been sold, and the banks have begun repaying their loans.

The broader socio-economic effects of the GFC on the UK economy were significant. GDP growth fell substantially from 2.6 percent in 2007 to -4.3 percent in 2009[72], while the unemployment rate gradually increased from 5.2 percent in early 2008 to 7.9 percent in mid-2009, before reaching a peak of 8.5 percent in late 2011[73]. Prior to this, the UK had not experienced these levels of unemployment since 1995.

[69] Bank of England, 2011, Quarterly Bulletin for Q3
[70] The National Audit Office published a total support figure of £1,161.88 billion at its peak. Note that, as each scheme and support facility was available at different times, the total peak support was not all available at a single point in time."
[71] National Audit Office
[72] World Bank, available online: http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?end=2016&locations=GB&start=1990
[73] Office for National Statistics, available online: https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/timeseries/mgsx/lms

Chapter 3: Robust and evolving legal and regulatory framework

Summary

The financial system has a robust and comprehensive legal and regulatory framework. To date, this framework has served to balance competition and innovation with the need for financial stability and adequate protection of customer outcomes. Competition hurdles are appropriately low. As a result, Australian customers have a wide variety of financial service providers and solutions to choose from, and are able to make informed decisions and act upon these decisions easily, while being afforded appropriate protections.

Although some recent financial regulatory reforms are likely to increase competitive hurdles, particularly around capital requirements, Commonwealth Bank believes that these measures are appropriate to ensure that Australia's financial system is unquestionably strong. Nonetheless, additional reforms have recently been implemented, or are proposed, which are likely to foster more competition. Commonwealth Bank is broadly supportive of these reforms and will continue to engage closely with regulators and policymakers to ensure that any reforms continue to improve customer outcomes.

A strongly regulated financial system with unquestionably strong banks is critical to protect customers and to support the economy through times of economic prosperity and economic hardship. Consequently it is critical that any new policies or regulation consider "through the cycle" implications, particularly for customer protection and financial stability. It is also critical that there is uniform application of regulation for all financial system participants.

The legal and regulatory framework in Australia is robust and promotes competition

Commonwealth Bank supports the current regulatory framework and believes that it is robust, comprehensive and appropriately balanced to promote competition, preserve financial system stability and protect customers.

In 2013 the Government commissioned a "root and branch" review of Australia's competition laws and policy to ensure Australia continues to experience long-term productivity growth (known as the "Harper Review"). In 2015, the Harper Review Panel published its final report and concluded that "The central concepts, prohibitions and structure enshrined in the [Competition and Consumer Act (2010)] should be retained, since they are appropriate to serve the current and projected needs of the Australian economy"[74]. Notwithstanding this, the Panel recommended for competition law provisions to "be simplified, including by removing overly specified provisions and redundant provisions"[75] and for enhancements to the ACCC's governance structure.

[74] Harper, I., 2015, Competition policy review, final report, available online at: http://competitionpolicyreview.gov.au/files/2015/03/Competition-policy-review-report_online.pdf. Note that the Panel also considered that the "competition laws could be simplified while maintaining their current policy intent. Business and consumers would benefit from simplification of the law." The Government broadly agreed with these findings and reforms to the legislation are currently in-train.

[75] Harper, I., 2015, Competition policy review, final report, available online at: http://competitionpolicyreview.gov.au/files/2015/03/Competition-policy-review-report_online.pdf

In May 2017 the Government announced the expansion of the ACCC's mandate to undertake regular inquiries into specific financial system competition issues, through the establishment of the Financial Services Unit. This new responsibility, together with recommendations from the Harper Review to simplify and strengthen the ACCC's role in monitoring competition, is likely to foster a more competitive environment.

In 2014 the FSI identified five areas to "improve the current arrangements and ensure regulatory settings remain fit for purpose in the years ahead"[76]. Amongst these, the Inquiry recommended that the Government "provide more clarity around its expectations of regulators"[77], and that ASIC's mandate and resources should be strengthened.

While ASIC's express mandate was not expanded to include competition, as recommended by the FSI, ASIC states one of its priorities as "ensuring fair, orderly and transparent markets achieved through [its] role in market supervision and competition, and corporate governance"[78]. As such, ASIC has to date fulfilled a key role in the financial system by encouraging competition within the scope of its existing powers.

Further, the Government announced that APRA will be given additional powers with respect to provision of credit by non-ADI lenders to complement its existing mandate. This power will enable the regulator to respond more flexibly to financial and housing market developments that pose a risk to financial system stability.

Given the significant number of changes that have been recently implemented or are likely to be implemented in the near-term, Commonwealth Bank believes that the impact of these changes should be assessed before any further interventions are considered, and that any proposals to expand regulator mandates must consider the risk of duplication or overlap among the roles of the regulatory bodies.

Competition hurdles in the financial system are low and appropriately balanced

Competition hurdles can be either regulatory (including financial and non-financial) or non-regulatory in nature. A healthy, robust financial system requires strong prudential regulation and as such, it is important to note that some hurdles are necessary to assure sustainable economic health and customer protections. Commonwealth Bank believes current regulation has balanced these demands appropriately.

In the 2017 Budget, the Government solidified its commitment to establishing Australia as "the leading global financial technology ("FinTech") hub"[79] by announcing a package of proposed changes including: relaxing the 15 percent ownership cap for new market entrants; removing the prohibition on the use of the word "bank" by entities with less than $50 million in Common Equity Tier 1 ("CET1") capital; and introducing a phased approach to the bank licensing process. FinTech competitors are also able to contribute to policy development via the Treasurer's Fintech Advisory Group.

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[76] Murray, D., 2014, Financial system inquiry, final report, available online at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

[77] Murray, D., 2014, Financial system inquiry, final report, available online at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

[78] Australian Securities & Investments Commission, 2017, Our role, available online at: http://asic.gov.au/about-asic/what-we-do/our-role/

[79] Australian Government, 2017, Budget 2017-18: Backing innovation and fintech, available online at: http://www.budget.gov.au/2017-18/content/glossies/factsheets/html/FS_innovation.htm

The Government and industry are working together to understand and design an Open Banking regime and a comprehensive credit reporting ("CCR") regime, that adequately balance the need for competition and innovation, with positive customer outcomes and protections. Commonwealth Bank broadly supports these and other current reforms to lower hurdles as outlined below.

Financial regulatory hurdles:

In July 2017, APRA announced new capital adequacy requirements for ADIs to reflect its goal of an "unquestionably strong" banking sector. While APRA acknowledged that Australia has benefitted from maintaining "a robust and well-capitalised banking sector" to date, it said that stronger capital ratios will equip the sector to "better handle periods of adversity in the future"[80]. Commonwealth Bank supports the strengthening of CET1 capital requirements as this assures improved outcomes "through the economic cycle".

Simultaneously, APRA is seeking to increase competition in the financial system by considering the introduction of a phased licensing approach for ADIs, with substantially reduced capital requirements of $3 million in the first phase. This is aimed at allowing new business models to begin limited operations and gain traction with customers, while still developing the requisite resources and capabilities to meet the broader prudential framework. Given the impact of similar initiatives by the Prudential Regulation Authority in the United Kingdom[81], these reforms are likely to further encourage and enable competition.

After the FSI recommended that mortgage risk-weights for banks using internal ratings-based ("IRB") models should be increased to an average of 25 percent for competition reasons, APRA implemented this at Commonwealth Bank in two stages on 1 July 2016 and on 30 June 2017. Further, to meet the "unquestionably strong" benchmark, APRA recently increased capital requirements for all IRB banks by the equivalent of around 150 basis points. For non-IRB ADIs the effective increase in capital requirements is approximately 50 basis points. As a result of these reforms, APRA expects a narrowing of any divergence in capital requirements between ADIs using the two methodologies[82].

Non-financial regulatory hurdles:

As a global leader in financial services innovation, Commonwealth Bank supports recent regulatory initiatives and reforms that lower hurdles for innovation in the financial system insofar as they continue to ensure financial system stability and the protection of customers. Commonwealth Bank believes that all initiatives and reforms should apply uniformly to all competitors and improve customer outcomes.

The Government announced its intentions to relax the 15 percent ownership cap for new market entrants. Currently, under the Financial Sector (Shareholdings) Act (1998), an individual shareholder or

[80] Australian Prudential Regulation Authority, 2017, Information Paper: Strengthening banking system resilience – establishing unquestionably strong capital ratios, available online at:
http://www.apra.gov.au/adi/Documents/Unquestionably%20Strong%20Information%20Paper.pdf

[81] From 2013-2017, there have been 39 new banks as approved by Bank of England, including digital challenger banks such as Atom Bank, Monzo Bank, Starling Bank (Bank of England)

[82] Australian Prudential Regulation Authority, 2017, Information Paper: Strengthening banking system resilience – establishing unquestionably strong capital ratios, available online at:
http://www.apra.gov.au/adi/Documents/Unquestionably%20Strong%20Information%20Paper.pdf

group of associated shareholders are limited to 15 percent of an ADI's voting shares, unless an exemption has been granted by the Treasurer or APRA. By reviewing this legislative requirement, the hurdles will be lowered for foreign bank subsidiaries looking to enter the Australian market, or foreign ownership and investment into new business models.

APRA recently announced its intentions to introduce a phased approach to licensing of new entrants into the banking industry. This will include the introduction of a "restricted ADI licence" for eligible applicants seeking to become ADIs. APRA proposes to impose alternative requirements on these licence-holders, including limits on the maximum size of deposits from a single depositor and on the aggregate amount of deposits[83], minimum capital adequacy and liquid holdings, restricted product offerings and reporting requirements. APRA Chairman Wayne Byres' stated these changes "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"[84].

ASIC is also strengthening its support for new market entrants with recently announced enhancements to its "regulatory sandbox", enabling new businesses to test a wider range of new financial products and services without a licence. This includes providing financial advice, issuing consumer credit, and offering short-term deposit or payment products. ASIC is also providing advice on licensing requirements and additional resources through its "Innovation Hub".

Given the robust and comprehensive regulation and oversight of the financial system, Commonwealth Bank recognises that compliance requirements are significant and crucial to compete effectively. Commonwealth Bank is encouraged therefore, by the emergence of regulation technology ("RegTech") competitors that are seeking to lower the burden of ongoing compliance, which will in turn enable new and smaller competitors to compete more effectively. In Australia there are currently 45 RegTech competitors[85]. Across the globe RegTech has experienced significant growth. In the first half of 2017, US$591 million was invested in RegTech, already exceeding the US$583 million raised during all of 2015[86].

While Commonwealth Bank recognises the impact these initiatives will have on new and smaller market entrants, and is broadly supportive of lowering hurdles for entry and scale, Commonwealth Bank notes that most of these initiatives favour new entrants and are not made equally available to all competitors. Uniform access to these resources would be more appropriate and would lead to improved customer outcomes by enabling deeper innovation within a "safe environment".

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[83] Australian Prudential Regulation Authority proposes a maximum deposit size of $250,000 per depositor, and a maximum aggregate deposit amount of $2 million for Restricted Licence-holders.

[84] Australian Prudential Regulation Authority, 2017, APRA consults on changes to authorising new entrants to banking industry, http://www.apra.gov.au/MediaReleases/Pages/17_31.aspx

[85] KPMG and The Committee for Sydney, 2017, Scaling the fintech opportunity for Sydney and Australia, available online at: https://home.kpmg.com/au/en/home/insights/2017/08/scaling-fintech-opportunity-sydney-australia.html

[86] KPMG, 2017, The pulse of fintech: Q2'17, available online at: https://home.kpmg.com/au/en/home/insights/2017/04/pulse-of-fintech.html

Non-regulatory hurdles

Historically, acquiring access to distribution channels has been one of the greatest hurdles to competing in the financial system as a new or small competitor. With the sharp rise in digital adoption by consumers globally and particularly in Australia, driven by a relatively high degree of digital innovation by Australian banks, it is now easier and more cost-effective than ever for new or small competitors to serve millions of customers and build scale rapidly. In Australia 86 percent of the population have access to the internet at home[87], with smartphone ownership of 84 percent exceeding countries such as Canada.[88] This trend is expected to continue, underpinned by further technological advances including open source software and software-as-a-service ("SaaS") solutions.

Commonwealth Bank sees numerous examples of new business models successfully building scale. For example, start-ups such as TransferWise, Xoom, World First and OFX have scaled by providing customers with low-cost solutions for overseas funds transfers. Locally, AfterPay has scaled by providing an alternative deferred payment solution to credit cards. Commonwealth Bank believes that the competitive conditions to enable new digital businesses to enter and grow in the Australian market are as good, if not better, than in comparable markets.

Introduction of an open data regime

Commonwealth Bank notes the Government's efforts to introduce an open data regime in Australia. Commonwealth Bank supports the creation of a comprehensive consumer right to access their data and is contributing to the current Treasury review on the subject of implementing an "Open Banking" framework.

Commonwealth Bank recognises the benefits of open data and supports the Productivity Commission's recommendation that the best model is one that places customers in control of access to their data. Commonwealth Bank also notes that an appropriately framed open data regime has the potential to assist financial service providers to offer more consumer orientated products and services. Further, Commonwealth Bank recognises that an open data regime may assist small and new competitors to scale quicker, by broadening their access to data for testing and tailoring solutions. Australia's Major Banks are already engaged in over 50 partnerships with FinTechs and other new market participants. A safely framed open data regime could launch with many of these partners already signed-up, providing a strong basis for successful reforms.

Commonwealth Bank already gives customers a high level of access to data. For more than 10 years Commonwealth Bank customers have had the ability to extract their transaction data into CSV files. This functionality is free of charge and enables customers to access their data securely[89]. Commonwealth Bank is now working closely with Government and industry to take further steps and enhance this capability and support customers that wish to access and share their data securely with accredited third parties.

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[87] Australia Bureau of Statistics, 2014-2015, Households with internet access at home, available online at: http://www.abs.gov.au/ausstats/abs@.nsf/mf/8146.0

[88] Deloitte, 2016, Mobile Consumer Survey - the Australian Cut, available online at: https://www2.deloitte.com/au/en/pages/technology-media-and-telecommunications/articles/mobile-consumer-survey-2016.html. Multicountry study of mobile phone users around the world. The 2016 study comprises of 53,000 respondents across 31 countries and five continents. Canadian smartphone ownership rate in 2016 was 73 percent.

[89] For further detail, refer to Commonwealth Bank's Submission to the Productivity Commission on the Inquiry into Data Availability and Use

In voicing its support for an open data regime, Commonwealth Bank has noted that adequately protecting customer privacy and security remains a paramount concern and that banks have an important role to play in building trust in a future "Open Banking" framework. A recent survey revealed that only 13 percent of Australian consumers were willing to share personal financial information. Around 62 percent of Australian customers said that they "were not happy to share personal financial information with anyone other than their bank,"[90] indicative of the trust that the Australian banks have built over time with our customers and the high level of protection they offer.

Commonwealth Bank Group has invested over $100 million per annum on its cyber defences in recent years[91], with the ultimate purpose of maintaining and enhancing the trust that Commonwealth Bank's customers have in its business and minimising fraud loss for customers. Over 2015-16, 86 percent of ASX100 organisations have experienced attempts to compromise confidentiality, integrity or availability of their network data or system[92]. Today, 80 percent of directors of Australia's top 100 listed companies expect the likelihood of cyber risk to increase within the short-term[93].

In 2015, Commonwealth Bank announced a five-year partnership with UNSW to develop a centre of expertise for cyber security education and research, aimed at boosting Australia's skills shortage in this area. More recently, Commonwealth Bank has been an active advisor to the Government on promoting national cyber resilience, and is a founding participant and steering committee member of the Government's inaugural Joint Cyber Security Centre.

Figure 18 outlines a case study on the potential, wide-spread implications of an open data regime without adequate safe harbours and regulation in place to protect customer outcomes and financial service providers such as Commonwealth Bank.

Figure 18:

Case study – Appropriately balancing open data with liability and accountability

Anna uses a third-party Personal Financial Management ("PFM") app to track her spending and saving each week, with the goal of maximising saving before her upcoming holiday. The app asks Anna to share her Commonwealth Bank NetBank ID and password, and then uses algorithms to sort her transactions into various categories.

Using a "sweep" function, the tool rounds up some of her transactions to the nearest $10 and asks her whether she wants to automatically transfer some of these funds into a separate, high-interest savings account, which she does regularly to add to her savings pool. The app gives her daily, weekly and monthly views to help her track her spending and saving.

However, the PFM app provider has not adequately invested in sophisticated IT and risk management systems and is subject to a cyber-attack. Commonwealth Bank is aware that Anna has shared her credentials with a site that uses screen-scraping to access its website, as this is detected by Commonwealth Bank's cyber security monitoring. However, Commonwealth Bank cannot technically stop the screen scraping, and can only include instructions that credentials should not be shared as part of the information provided to customers. Anna's personal banking

[90] Boston Consulting Group, 2016, Retail banking excellence consumer survey based on 42,000 respondents in 16 countries, fieldwork took place between December 2016 and January 2017
[91] Steve, P., 2017, AB Symposium transcript of opening remarks, includes projects spanning the Group
[92] Australian Cyber Security Centre, 2016, Cyber Security Survey, available online at: https://www.acsc.gov.au/publications/ACSC_Cyber_Security_Survey_2016.pdf
[93] ASX, 2017, ASX 100 Cyber Health Check Report, available online at: http://www.asx.com.au/documents/investor-relations/ASX-100-Cyber-Health-Check-Report.pdf

details, as well as transaction history and spending behaviours are now at risk of being accessed by third-parties.

The financial and reputational risks and liabilities are borne by Anna as well as her financial institution, Commonwealth Bank. Commonwealth Bank is liable for fraudulent transactions under the APCA ePayments code, which does not apply to the PFM app provider.

In this case, an unregulated actor (the PFM) has been able to access Anna's data through illegitimate means. Screen scraping is not an authorised method to access data, and ultimately Anna will be exposed to risk as she will not have access to the normal protections she would under the ePayments code.

Commonwealth Bank is supportive of an open data regime that features:

- a Government and industry-enabled data sharing framework where data is accessed and shared only after clear, informed consent from participating customers;
- any organisation seeking access to data (including banks) should be certified so that consumers are able to rely on the trustworthiness of the firm;
- clear denouncing of practices (such as password sharing) that have the potential to undermine the concept of safe data sharing and negatively impact customers;
- robust safeguards to ensure that customer and regulator expectations of privacy and security are met, including ensuring that consumers have the right to opt-out and data is used in accordance with their directions;
- clear allocation of accountability between participants for security and risk controls, and allocation of liability for losses in line with that accountability (for example, by updating the liability provisions of ASIC's ePayments Code);
- clear sharing of responsibility between financial services providers for security and risk controls and shared liability for breaches; and
- industry-led implementation of banking sector specific guidelines, to ensure a well-designed and robust model that maintains customer confidence.

Commonwealth Bank's view is that the potential benefits of open data are best realised with a well-considered implementation approach. Commonwealth Bank welcomes the Government's goals of increasing competition and innovation through productivity and enabling customer access to data. Commonwealth Bank is strongly supportive and will constructively contribute to the Government's agenda to establish an open data regime. We look forward to actively contributing to the Treasurer's Open Banking independent review and work together with industry and Government to frame the right solution for the Australian economy.

Introduction of Comprehensive Credit Reporting

Commonwealth Bank supports a CCR regime, recognising that such an initiative has the potential to deliver positive customer outcomes through increased credit availability and hence, wider customer choice. A CCR regime can also benefit financial services providers by allowing them to have a more holistic view of the customer and thereby drive more informed credit decisions. However, Commonwealth Bank also notes that if improperly implemented CCR has the potential to deliver unintended negative customer consequences.

To date, Commonwealth Bank has invested in key structural components that will support the adoption of CCR. For example, Commonwealth Bank has introduced a single bureau hub connected to the credit bureau to simplify the implementation of a CCR regime, introduced enhanced data quality frameworks, participated in pilot studies to assess the impact of CCR, and continues to participate in industry-led initiatives to form Rules of Reciprocity and Data Standards. Further development of systems, processes and data supply will be required to ensure that Commonwealth Bank is able to offer CCR to customers in a secure manner.

Credit information is a subset of consumer data and thus consumers' privacy must be appropriately protected, that is, the data should only be used where the customer has made a request for a credit product, for the limited purpose of approving the credit product. Commonwealth Bank believes that regulations around the secondary use of credit data should be reviewed carefully to ensure that this data is only used in accordance with users' expectations.

A key mechanism by which CCR could be expected to deliver its benefits in terms of efficiency is through more granular pricing that is based on risk. Commonwealth Bank notes that CCR has the potential to lead to an increasing prevalence of risk-based pricing, whereby "high-risk" customers are required to pay high interest rates. This has been seen in other countries following CCR adoption including the UK and the USA. Commonwealth Bank, along with customer advocacy groups, believes that this will likely result in financially vulnerable customers paying higher rates and thus amplify the impacts of financial disadvantage and/or hardship. One factor contributing to this problem is that existing systems provide information regarding customers' credit limits but do not indicate how much of that credit has been utilised. A careful assessment needs to be conducted regarding the impact of including this partial information in credit decision processes.

Commonwealth Bank believes that these issues should be considered jointly by Government and industry and supports educating consumers about the potential impact of a more extensive credit reporting system on their financial wellbeing.

Commonwealth Bank advocates for a regime that appropriately balances increased competition with the potential for positive and negative customer outcomes.

Mortgage broker reforms

Commonwealth Bank believes brokers should and will continue to play an important role in the mortgage market.

Commonwealth Bank has welcomed initiatives to enhance industry transparency, including in the mortgage broker channel. To date, Commonwealth Bank has been and will continue to introduce recommendations from ASIC and Sedgwick reviews in consultation with the industry and related industry bodies.

ASIC's review of mortgage broker remuneration has led to ASIC making recommendations around improving the standard broker commission model; moving away from bonus commissions, bonus payments and soft dollar benefits; clearer disclosure of ownership structures; a new public reporting regime; and improved oversight and governance of brokers and broker businesses[94]. Commonwealth

[94] Australian Securities & Investments Commission, 2017, Review of mortgage broker remuneration, available online at: http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf

Bank welcomes this review and remains committed to making changes that deliver better customer outcomes and promotes competition in the home lending market.

Commonwealth Bank currently discloses ownership structures throughout the customer experience, including via its marketing collateral, external websites and loan documentation. Commonwealth Bank welcomes proposals to further support clear disclosure of ownership structures across the industry. However, the basis for further change should have regard to the effectiveness of existing regulated disclosures, including Financial Services Guides and other marketing materials. Consideration of future disclosure changes should also include consumer testing.

Account and provider switching

In Australia's financial system customers have a broad range of providers and products to choose from. Commonwealth Bank understands that the ability to quickly and cheaply switch between products and providers is key to customers harnessing the benefits of competition. As such, the industry has made significant strides towards enabling seamless and rapid switching.

A recent survey conducted by Galaxy Research found that one in six Australian retail consumers had switched their main bank in the past three years. Of those customers that had switched, 68 percent found the process easy[95]. At Commonwealth Bank, closing a savings or transaction account (with no pending transactions) can now be completed within one business day via phone or branch. Commonwealth Bank customers can also close their credit card accounts immediately online (via NetBank or the CommBank app) or within two business days if closed via phone or a branch when the balance has been paid off in full[96]. When compared with international markets, the switching process is relatively frictionless and convenient for Australian customers. For example, in the UK, it was reported that more than 99.5 percent of switches are completed within the seven working day required timeframe when using the Current Account Switching Service ("CASS")[97].

While the industry has invested in making account and provider switching easy for customers, Commonwealth Bank recognises there is more that can, and will be done. A recent survey conducted by Commonwealth Bank found that 77 percent of the people in Australia find it appealing for banks to work together to make switching easier[98]. As a result, the industry is committed to continually enhance the switching experience for consumers.

Commonwealth Bank also recognises a hurdle to switching is the need for customers to identify and port direct entry and recurring payments to their new account or provider. Through the Australian Bankers' Association ("ABA"), the industry has proposed to work with the credit cards scheme providers to address customer concerns of how recurring payments are processed against closed card accounts.

In 2011, the Government noted that a system enabling account number portability would be a "massively expensive undertaking"[99] in Australia. The proposition is likely to increase costs for small competitors in the financial system. Accordingly, Commonwealth Bank does not believe mandated

[95] Australian Bankers' Association, 2017, Account Switching, available online at: https://www.betterbanking.net.au/better-products/account-switching/

[96] Note that 'pending transactions' must be settled before closure of savings accounts, transaction accounts or credit cards

[97] Bacs, 2017, Current account switch service dashboard, Issue 15

[98] Consumer Survey, 2017. Comprised of representative sample of 506 Australians. Proportion holding an account/personal banking product with: ANZ: 22 percent; CBA: 40 percent; NAB: 22 percent; Westpac: 24 percent.

[99] Australian Government, 2011, Banking Services: switching arrangements report, Australian Government, available online at: https://banking.treasury.gov.au/content/reports/switching/downloads/switchingarrangements_aug2011.pdf

account number portability would improve the competitive landscape, and in addition it would impose a disproportionately large financial impost on smaller banks.

Commonwealth Bank believes initiatives underway to improve the ease and convenience of switching accounts and providers are the least cost approach. As such, Commonwealth Bank believes that the switching process should continue to be led by industry, and that any regulatory intervention considers the costs and benefits of proposed reforms, as well as learnings from international efforts to improve the ease of switching (refer to Figure 19 for a case study on the impact of CASS on customer switching rates).

Figure 19:
Case study – The UK's Current Account Switching Service

CASS was introduced in September 2013 in the UK in an effort to encourage personal current account switching by making it easier to change from one provider to another. CASS is underpinned by the Current Account Switch Guarantee which promises consumers the following:

- Switching will be completed within seven working days (in contrast to 18 to 30 working days prior to the launch of CASS).
- Switching will go through on a date of their choosing.
- All funds and regular payments will be transferred to the new account by the new current account provider.
- Any payments to or from the old account will be redirected to the new account for a period of 13 months.
- If anything goes wrong, any charges incurred or interest lost as a result of any errors will be refunded.

The introduction of the service was the result of recognition by the UK government and Payments Council that one of the possible hurdles for potential switchers was anxiety about the switching process.

In 2015 the UK's Competition and Markets Authority recommended a series of initiatives to boost awareness and confidence in CASS, following its investigation into the Personal Current Accounts market. Since 2013, the central switching engine has processed approximately 3.9 million switches[100], with the majority of these switches for retail customers. CASS is a voluntary program and as such, 47[101] of the major banks have signed up to participate. However, the Composite Confidence score for the service was 67 percent as at June 2017, well below the target score of 75 percent[102]. Although total switching volumes in the UK increased by 12 percent following the implementation of CASS, volumes subsequently decreased by 8 percent in 2015 and 5 percent in 2016[103]. As a result, annual switching volumes are now lower than prior to the introduction of the service.

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[100] Bacs, 2017, Current account switch service dashboard, Issue 15

[101] Bacs, 2017, Current account switch service dashboard, Issue 15

[102] Bacs, 2017, Current account switch service dashboard, Issue 15

[103] Payments Council, 2014, Current account switch service dashboard and Bacs, 2015-2016, Current account switch service dashboard

Commonwealth Bank also sees an opportunity to review the legacy rules and systems which govern the establishment and maintenance of direct debit arrangements in the Australian payments system. In particular, digitising and potentially creating a central repository for efficient maintenance of direct debit authorities. Such measures may remove friction for customers switching providers, as well as enhancing the manner in which disputed transactions and other customer complaints are handled.

Digital identification services

As articulated in Commonwealth Bank's submission to the FSI, the broad availability and more effective use of secure digital identities will underpin trust and value in the digital economy. Since June 2014, Commonwealth Bank has offered customers the functionality to identify themselves and open a new account completely online. Since April 2016, Commonwealth Bank has enabled individual customers to go through the identification and account opening process through the CommBank smartphone app.

Commonwealth Bank believes that the current combination of several private and public sector sources for digital identity verification encourages innovation and competition in digital identity solutions. Small and new market entrants such as digital-only banks can thus leverage these solutions for their customer on-boarding needs, at a relatively low-cost. The national online Document Verification Service ("DVS") is a Government resource which is also open to new market entrants via a number of authorised Gateway Service Providers that facilitate access to the DVS on a commercial basis. As such, all private sector users of the DVS, including Commonwealth Bank, have access to the same customer information.

New Payments Platform ("NPP")

The introduction of real-time payments between banks through the NPP initiative will encourage and enable innovative solutions. However, given NPP is an account-based solution, Commonwealth Bank recognises that switching direct debits will only target a portion of all customer transactions.

Interchange fees

In May 2016 following a review of Card Payments Regulation, the RBA announced changes to interchange fee benchmarks which took effect on 1 July 2017. The RBA noted that these changes would benefit customers and level the playing field for financial services providers by "improving the efficiency of the payments system, reducing payment costs of merchants, reducing cross-subsidisation across customers paying with different payment methods, reducing the need for surcharging of more expensive cards, reducing the focus on rewards programs, and reducing competition hurdles for potential new methods of payment"[104].

Other recently implemented or anticipated reforms will further improve competition and customer outcomes

Commonwealth Bank notes that there are a number of other reforms both recently put in place, as well as in-train to be implemented, for which the impact on competition in the financial system is yet to be seen. Commonwealth Bank expects the combination of these reforms will further enhance competitive pressures and improve customer protections, and strongly believes that Government should first

[104] Reserve Bank of Australia, 2016, Review of card payments regulation conclusions paper, available online at: http://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/pdf/review-of-card-payments-regulation-conclusions-paper-2016-05.pdf

monitor and assess the impact of these changes before considering further policy or regulatory intervention.

- **Competition Policy Review:** While the Harper Panel was generally comfortable with the Competition and Consumer Act, some provisions were deemed "unnecessarily complex, contributing to business and regulatory uncertainty and imposing costs on the economy." The Government was broadly supportive of the Panel's recommendations and a number of legislative reforms are underway with the aim of simplifying competition laws and making it easier for the ACCC to prove anti-competitive behaviour, particularly with regards to "concerted practices", and expanding the ACCC's powers and improving customer access to remedies, particularly for SME businesses. The Review also made recommendations on informed choices which are being addressed through the Government's inquiry into an open data regime in the banking sector.
- **Interest rates and informed choice in the credit card market:** Government recently committed to address a perceived "lack of competition on ongoing interest rates, customers in unsuitable card products, over-borrowing and under-repayment"[105] in the credit card market. Reforms include requiring credit providers to conduct affordability assessments to ensure customers can repay their credit limit within a reasonable period; banning unsolicited offers of credit limit increases; simplifying how interest is calculated; and requiring online options to cancel cards or to reduce credit limits[106]. Commonwealth Bank has proactively implemented a number of reforms, such as offering customers the ability to close their credit card account online in real-time. This complements a number of recent customer-centric credit card features which have increased transparency. They include allowing customers to reduce their credit card limits, set spending caps online, and sending payment reminders to customers to make their repayments on time, which has saved customers approximately $7 million per year in late payment fees.
- **Technology neutrality:** Commonwealth Bank recognises regulatory efforts to enable the industry to provide products and services to customers via different modes, including digitally. For example, ASIC recently published guidance on Facilitating Digital Financial Services Disclosures and Providing Digital Financial Product Advice to Retail Clients[107]. However, Commonwealth Bank believes that further work can be done, particularly around financial services disclosure provisions and industry codes, to ensure that regulation is technology-neutral and promotes innovation in interacting with, and providing information to customers, in accordance with their evolving expectations.

Ad-hoc interventions put Australia's financial system at risk

Commonwealth Bank is concerned that ad-hoc statutory or regulatory interventions in the financial system can have unintended consequences if due consideration is not given to financial system stability "through the economic cycle".

In this context, the Government's Major Bank Levy and the South Australian government's similar proposed levy appear relevant. These policies introduce an element of sovereign risk that previously wasn't considered to be an issue relating to the credit ratings of all Australia's banks thus potentially

[105] Australia, Government, 2016, Credit cards: Improving customer outcomes and enhancing competition, available online at: https://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Credit%20card%20reforms/Key%20Documents/PDF/Credit_card_reforms_CP.ashx

[106] Treasury, 2017, Draft legislation – Protecting Aussies from predatory credit card practices, available online at: http://sjm.ministers.treasury.gov.au/media-release/075-2017/

[107] See Australia Securities & Investment Commissions' RG221 and RG255

reducing the competitiveness of Australia's financial system when accessing capital offshore to fund Australia's current account deficit.

The levies will also add costs to Australia's five largest banks which may adversely affect customer outcomes by potentially reducing the sector's capacity to invest in value adding services and limiting innovation.

The rationale provided for these levies included promoting competition, as they exclude all Australian banks but the five largest, and excluded all large foreign banks. Specifically, the exclusion of large foreign multinational banks from the levies provides an unfair competitive advantage for foreign banks to compete in the Australian market leveraging large off-shore balance sheets. Foreign banks have strong credit ratings that enable them to raise wholesale funds offshore and bring them to Australia, leaving Australian banks at a disadvantage. Foreign banks operating in Australia already hold 10 percent (by value) of all banking deposits in Australia, equating to $214 billion. This is in contrast to the $130 billion of deposits held by the regional banks[108].

One argument advanced for the decision to include only large Australian banks in the Government's Major Bank Levy was to correct the competitive impacts of an "implicit guarantee". Commonwealth Bank does not believe that there is, nor should there be, an "implicit guarantee" for Australia's Major Banks. General Government support for the whole banking industry is important, and is critical in periods of stress.

If the Government is to address the effects of a perceived "implicit guarantee" for Australia's Major Banks, the best tool for minimising the impact would be to increase the resilience of the financial system, as recommended by the FSI.

It is worth noting that there is a difference between an implicit Government guarantee for particular banks and general Government support. As demonstrated during the GFC, the Government provided support to all banks, both major and non-major, and it is this form of general support that was exercised:

- Almost all banks had access to the "Government Guarantee Scheme for Large Deposits and Wholesale Funding".
- All banks' deposits were automatically guaranteed under the Financial Claims Scheme, although it largely benefited smaller banks who experienced significant deposit outflows.
- All banks had access to the $20 billion RMBS purchase program through the Australian Office of Financial Management. This was predominantly utilised by smaller banks, which were relatively more reliant on the securitisation market for funding.

Australian banks paid $4.5 billion in fees for access to the Wholesale Funding Guarantee scheme. The Government implemented the scheme not because of the weakness in the Australian banking sector. Rather, it was acknowledged by Treasury that:

> *"When foreign governments began to guarantee the debt of their home banking sectors, this put Australian banks at a disadvantage in attracting capital, potentially threatening their intermediation of credit to businesses and households."*

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[108] Australian Prudential Regulation Authority, 2017, Monthly banking statistics, available online at: http://www.apra.gov.au/adi/Publications/Pages/monthly-banking-statistics.aspx

Support for all banks is important because, as also demonstrated by the way in which the GFC unfolded in Australia, smaller banks are typically more likely to fail than larger banks.

Uniform regulation for all financial system participants is important

Financial market participants without sound business and risk management behaviours can thrive in supportive economic conditions, but may prove to be less successful and even fail during downturns. Remaining viable "through the economic cycle" is important to both customer protection and financial system stability.

Enshrining different levels of regulation covering participants in the financial system puts the stability of the system and protection of customers at risk, by enabling growth in the shadow banking sector.

Some of the new market entrants and emerging business models described in Chapter 1 (in particular those that represent shadow banking) are less well-regulated than traditional banks. In the event of a downturn, they may introduce greater risk to investors, customers and the financial system. For example, models for simplified mobile-based investing and trading target unsophisticated investors with low cost options. These have the potential to make financial markets more accessible, but also carry risk when targeted at a cohort that is less financially literate and yet to experience an economic downturn, unless these products are accompanied by a commensurate simplification in disclosure materials.

Furthermore, several new business models have emerged recently that have tailored their offerings to operate outside of existing regulation. These business models circumvent existing legislation, and take advantage of the gaps in these laws. For example there are, or have been, instances of non-bank lenders including those targeting the property market that are not regulated by APRA.

Additional measures to encourage innovation from new market entrants have also been unevenly applied to competitors in the financial system. For example, access to ASIC's Innovation Hub including the recently extended "regulatory sandbox" has only been provided to FinTech competitors, in contrast to markets like Singapore where sandboxes are available to all financial market participants. Commonwealth Bank believes that the "regulatory sandbox" should be extended to be accessible for all market participants, to encourage further innovation and collaboration between existing participants and new market entrants. Commonwealth Bank believes there should be an even regulatory playing field for Australia's Major Banks and other financial services competitors, including irrespective of the extent to which the organisation is vertically or horizontally integrated.

Protecting customers will be a regulatory challenge as the industry evolves

Commonwealth Bank notes that banks in the financial system are strictly regulated and overseen by several regulatory bodies. In conjunction, Australia's Major Banks have committed to protecting customer outcomes and upholding customers' confidence through significant investments in cyber security. This is critical investment to Australia's economy given cybercrime is reported to cost people in Australia over $1 billion every year[109]. To build on these foundations, Commonwealth Bank believes that a regime whereby customer data is shared between parties, must be carefully constructed and controlled.

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[109] Commonwealth of Australia, Dept. of the Prime Minister & Cabinet, 2016, Australia's cyber security strategy, available online at: https://cybersecuritystrategy.pmc.gov.au/assets/img/PMC-Cyber-Strategy.pdf

Commonwealth Bank broadly supports Open Banking and CCR reforms as these have the potential to achieve positive customer outcomes, as discussed above. However, there are risks to customer protection and integrity of the financial system in Australia that need to be carefully considered when designing and implementing these reforms. Customer protection, particularly in relation to data and privacy, needs to be ensured. For example, customer protection should address current customer willingness to share personal financial information outside their own bank (relatively low at 13 percent[110]). Customer data should also only be used for specific purposes as desired by customers, rather than for unlimited use by third-party financial service providers (for example, preventing use for unsolicited marketing). Further, any mechanisms to share data between banks needs to ensure appropriate controls are in place for use of this data.

Firms with business models dependant on the processing of sensitive personal data should be able to demonstrate how they meet standards of privacy and data protection in ways that are meaningful to customers and meet established industry standards.

The participation of overseas technology companies that are not subject to the same prudential standards as Australian participants raises challenges regarding the potential off-shoring of customer data. In this context, regulators must be able to identify which micro-services are growing rapidly and thus may pose new system-wide risks, while ensuring that regulation still provides adequate protection for individual customers.

As such, Commonwealth Bank supports the strong regulation and oversight of all competitors to continue balancing competition and innovation with financial stability, positive customer outcomes and experiences.

In order for the overall financial system to remain stable, new business models which are enabled through innovation need to be able to operate and perform well "through the cycle". Developments in peer-to-peer lending, robo-advice and algorithmic trading may promote riskier behaviour and exacerbate financial volatility without the requisite controls and protections in place for customers in the event of a system failure or economic downturn. Particular risk exists where shadow banking models could fail.

Findings from the Financial Stability Board report on "FinTech Credit"[111] indicate that as FinTech platforms account for an increasing share of credit provision, policymakers should consider the risk of negative consequences from potentially lowered lending standards, incentive problems from a reliance on fee income, and credit provision being retracted from certain parts of the economy in times of market stress. As such, policy and regulatory intervention must balance point-in-time concerns with long-term impact on participants' ability to deliver outcomes and protect customers "through the economic cycle".

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[110] Boston Consulting Group, 2016, Retail banking excellence consumer survey based on 42,000 respondents in 16 countries, fieldwork took place between December 2016 and January 2017

[111] Working Group established by the Committee on the Global Financial System and the Financial Stability Board, 2017, FinTech credit, available online at: http://www.fsb.org/wp-content/uploads/CGFS-FSB-Report-on-FinTech-Credit.pdf

Recommendations

Recommendation 1: Commonwealth Bank supports the Australian Government's intention to introduce a regime of open data and comprehensive credit reporting in banking and recommends appropriate measures be put in place to protect customers' privacy and security and uphold the stability of the financial system.

Recommendation 2: The rise of the shadow banking sector, an outcome of non-uniform regulation in the financial system, puts the stability of the system and protection of customers at risk. Commonwealth Bank recommends that legislation and regulatory policy be updated to ensure they apply uniformly to all competitors participating in the financial system.

Recommendation 3: Commonwealth Bank recommends that the anticipated impact of the breadth of statutory and regulatory changes currently being planned or implemented be carefully assessed when considering any further regulatory interventions.

Recommendation 4: Commonwealth Bank recommends that any regulation designed to stimulate competition should give consideration to "through the cycle" implications, in particular the potential risks to customer protection and/or financial system stability in the event of an economic downturn or period of economic volatility.

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Glossary

ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
ADI	Authorised Deposit-taking Institutions
AIB	Allied Irish Banks
APCA	Australian Payments Clearing Association
ANZ	Australia and New Zealand Banking Group
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities & Investments Commission
ATM	Automated teller machine
Australia's Major Banks	Australia's four largest banks: ANZ, CBA, NAB, WBC
Basel III	Set of reform measures developed by the Basel Committee on Banking Supervision
BMO	Bank of Montreal
BoA	Bank of America
BPAY	Electronic bill payment system
CAGR	Compounded annual growth rate
CASS	Current Account Switching Service
CBA	Commonwealth Bank of Australia
CCR	Comprehensive Credit Reporting
CET1	Common Equity Tier 1
CIBC	Canadian Imperial Bank of Commerce
Citi	Citibank
Consumer	Retail banking customer
Core Europe	UK, Germany, France and Belgium
CSV	Comma separated values file
DVS	Document Verification Service
Euro area	Countries that have adopted the euro as their common currency
FIAP	Financial Inclusion Action Plan
FOFA	Future of Financial Advice
FSI	Financial System Inquiry
FY	Financial Year
GDP	Gross Domestic Product
GFC	Global Financial Crisis
Government	The Government of Australia
HBOS	HBOS plc is a banking and insurance company in the UK
HSBC	Hongkong and Shanghai Banking Corporation Limited
IRB	Internal ratings-based
JPM	J.P.Morgan
MFI	Main Financial Institution
NAB	National Australia Bank
NAO	National Audit Office

NPP	New Payments Platform
OECD	Organisation of Economic Cooperation and Development
OTC	Over-the-counter
PEXA	Property Exchange Australia Ltd
PFM	Personal Financial Management
PNC	PNC Financial Services
RBA	Reserve Bank of Australia
RBC	Royal Bank of Canada
RBS	Royal Bank of Scotland
RMBS	Residential Mortgage-backed Securities
ROE	Returns on equity
SaaS	Software-as-a-service
Sedgwick review	Review into product sales commissions and product based payments in retail banking in Australia which was conducted by Mr Stephen Sedgwick
SME	Small to medium-sized enterprise
StanChart	Standard Chartered Bank
TD	Toronto-Dominion Bank
UK	United Kingdom
UNSW	University New South Wales
USA	United States of America
US Bancorp	Parent company of U.S. Bank, National Association
US Dollar	American dollar
WBC	Westpac Banking Corporation