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

20 MARCH 2018

This document should be read in conjunction with the Commonwealth Bank of Australia's Initial Submission (dated 15 September 2017)

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Executive summary

The Commonwealth Bank of Australia (CommBank) welcomes the Productivity Commission's (Commission) Inquiry into Competition in the Australian Financial System (Inquiry) on behalf of the Australian Government (Government) and the Inquiry's Draft Report (Draft Report).

CommBank believes a highly competitive banking system that is stable, fair, efficient and safe through the economic cycle is good for customers, shareholders and the Australian economy. It is working hard to create a better, stronger bank that focuses on customers' wellbeing, leads on operational standards and compliance, drives industry innovation, and contributes to communities and the economy in ways that reflect its size and heritage.

CommBank also believes it is important to deliver a highly competitive proposition to customers whilst ensuring responsible management of Australia's largest financial institution.

Over the last decade, the level of competition in the Australian financial system has increased. Innovations and regulatory changes 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).

For example, there is a long term declining market share trend for Australia's Major Banks collectively in home loan approvals and furthermore, there is significant volatility in underlying month on month market share movements between competitors which highlights vigorous levels of competition.

Despite Australia being a relatively small economy, Australian financial services customers have access to world-leading propositions with high levels of choice, innovation, accessibility and service quality. Nonetheless, CommBank recognises that there will always be opportunities for the industry to continue improving customer outcomes.

The intensity of competition in the Australian financial system is on par with other advanced economies[1] and the industry is also highly productive by comparison[2]. These competitive dynamics have delivered high customer satisfaction levels, reflected in the long term trend of increasing customer satisfaction that has risen to over 80%[3]. It is also important to note that there is a decreasing trend in customer dissatisfaction which is now less than 5%. CommBank is continually striving to better understand the needs of all customers' views, in particular by focusing on the individual concerns of dissatisfied customers.

Australia has enjoyed over 26 years of uninterrupted economic growth[4]. This is globally unprecedented. Given the procyclical nature of banking, it has naturally led to strong performance for Australian banks. This has flowed through to support the broader economy; almost 80% of Australian

1 Bullock, M., 2017, Big banks and financial stability, delivered 21 July, www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html.
2 Boston Consulting Group, 2016, Retail Banking Excellence Benchmark (Australia's Major Banks have lower operating expenses per customer compared to the global median).
3 Roy Morgan Research, Retail MFI Customer Satisfaction, Australian population 14 years+, 6 month rolling average to January 2018. Includes ANZ, CommBank excluding Bankwest, NAB and WBC excluding St George Bank. 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.
4 OECD, Main Economic Indicators Publication, available from OECD. Stat online: http://stats.oecd.org

banks' profits are returned to shareholders as dividends[5] and Australia's Major Banks are amongst the nation's largest taxpayers[6].

CommBank reiterates the importance of maintaining the stability and resilience of the Australian financial system as the primary aim of policy, whilst also ensuring customers are protected and competition is promoted for the benefit of customers. Systemic failures in banking typically result in catastrophic fiscal and socio-economic outcomes, as recently demonstrated by the impact of the Global Financial Crisis (GFC) on many advanced economies.

Financial system strength and stability, including perceptions of strength and stability, are particularly important given the Australian financial system's strong reliance on offshore wholesale funding in supporting economic growth. To put this in perspective, Australia's Major Banks alone raised almost $100bn of long term wholesale funding in offshore markets in FY17[7]. During this period CommBank raised $27bn offshore in long term wholesale funding, and renewed approximately $32bn offshore in short term wholesale funding on average each month. The reliance of the Australian economy on the strong credit ratings of Australia's Major Banks and their ability to access offshore markets at scale was critical in enabling CommBank to provide $135bn in new lending to Australian customers during this period.

At some point in the future, Australia is likely to experience a recession. Australia's regulatory settings must ensure that the financial system has the strength and stability to absorb losses and support economic recovery in this event. Whilst Australia's financial system was not as impacted by the GFC as many others, the factors that helped protect Australia's economy then (such as persistent demand for commodity exports and interest rates that were sufficiently high to enable expansionary monetary policy) are unlikely to exist, at least to the same extent, entering into the next downturn.

CommBank believes that Australia's regulatory framework is robust, comprehensive and appropriately balanced to promote innovation and competition, protect customers, and maintain the stability and resilience of the Australian financial system. Indeed, in November 2017 the international ratings agency S&P Global Ratings said that the existing laws and regulations governing Australia's banks are amongst the strongest in the world[8].

Any regulation designed to stimulate competition should give consideration to "through the cycle" implications, in particular the potential risks to customer protection, market integrity and/or financial system stability in the event of an economic downturn or period of economic volatility. CommBank continues to stress this view.

Whilst CommBank accepts many of the Draft Findings in the Draft Report, it rejects several of them and in particular those relating to the state of competition in the financial system, consumers' ability to apply competition pressure, implications of oligopolistic market structure, perceptions of 'too big to fail' and the Four Pillars policy. In CommBank's view the conclusions drawn in these Draft Findings do not give an appropriate and balanced assessment of the range of considerations that are relevant to each of the respective topics.

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5 ABA, https://www.banksbelongtoyou.com.au/

6 ATO, 2015-16 Report of Entity Tax Information, available online at: https://data.gov.au/dataset/corporate-transparency

7 Australia's Major Banks' annual reports. Note: CommBank has a 30 Jun-17 year end. WBC, NAB and ANZ have a 30 Sep-17 year end.

8 S&P, refer to AFR's article "Australian banks the best regulated in the world: S&P" (29/11/2017)

CommBank supports in principle or is unopposed to the majority of the Commission's Draft Recommendations. However, CommBank does not support the Commission's Draft Recommendations with regard to three matters:

The proposal to abolish interchange fees. The payments system is critical infrastructure for the nation. Investment is necessary to provide security, stability and continuous innovation. There have been successive reforms that have aimed to optimise interchange. Australia's interchange fees are low by global standards. There should be no further changes to these regulations until the Reserve Bank of Australia (RBA) has had the opportunity to evaluate the effects of the most recent reforms introduced last year.

The proposal for the Australian Prudential Regulation Authority (APRA) to develop an online tool to report median interest rates on home loans. CommBank's concern is this will likely have a number of significant unintended consequences. Mortgage pricing is determined by a number of factors, including a risk assessment of individual customers and external factors such as wholesale funding costs. Publishing historical median interest rates without the relevant personal context is likely to mislead customers and distort the decisions of lenders.

The proposal related to a duty of care for mortgage aggregators and brokers. CommBank supports recommendations that aim to protect customers and puts their interests first. However CommBank does not support the recommendation as currently expressed, as it applies only to aggregators owned by lenders. This would cause confusion for consumers as different brokers would have different service level obligations, and creates an unnecessarily uneven playing field for industry participants. Further, it would be important to ensure that any duty of care obligations allow for brokers to consider price together with the full range of product features that may be of value to customers, for example physical branch networks, access to digital banking, product flexibility (redraw, offset, etc.).

CommBank looks forward to working constructively with the Commission, the Government and regulators to address important design considerations to promote competition, protect customers and maintain the stability and resilience of the Australian financial system.

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Chapter 1: Industry context

1.1 Competition and regulation in the Australian financial system are healthy

Key Points

- A highly competitive banking system that is stable, fair, efficient and safe through the economic cycle is good for customers, shareholders and the Australian economy.
- There is vigorous competition between banks, demonstrated by high levels of customer satisfaction, material monthly volatility in market share of flows; high levels of investment in innovation; and high spend on marketing.
- Barriers to entry and expansion are low and falling and there is ongoing entry of new players across all parts of the value chain.
- 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 than in most comparable countries.
- ROEs in banking are comparable to other industries in Australia, and lower in many instances.
- Australia's regulatory framework is superior to most mature markets and CommBank supports the clear division of accountability between the RBA, APRA and the Australian Securities and Investments Commission (ASIC) to ensure system stability, prudential supervision, and customer protection and competition respectively. CommBank also supports the role of the Council of Financial Regulators (CFR) to balance these objectives to ensure Australia's economic prosperity and the financial wellbeing of customers.
- In addition, CommBank supports the role and mandate of the Australian Competition and Consumer Commission's (ACCC) new Financial Services Unit.

Summary of Response to Draft Recommendations

- CommBank is unopposed to ***Draft Recommendation 7.2 (Building an evidence base on integration*****)**.

Summary of Response to Draft Findings

- CommBank accepts ***Draft Finding 2.1 (Key features of workable competition in the financial system).***

A highly competitive banking system that is stable, fair, efficient and safe through the economic cycle is good for customers, shareholders and the Australian economy.

CommBank accepts ***Draft Finding 2.1 (Key features of workable competition in the financial system).***

CommBank supports the Commission's assessment of key features of workable competition and believe these already exist in the Australian financial system today or, as in the case of Open Banking, will be implemented shortly. These features and how they apply to the Australian financial system are discussed in detail throughout this submission.

CommBank supports competition and the ability for all Australians to choose a financial institution which best suits their needs. CommBank has supported the industry's advancements in enhancing the customer switching experience, while spearheading a number of initiatives to support customers to switch banks easily.

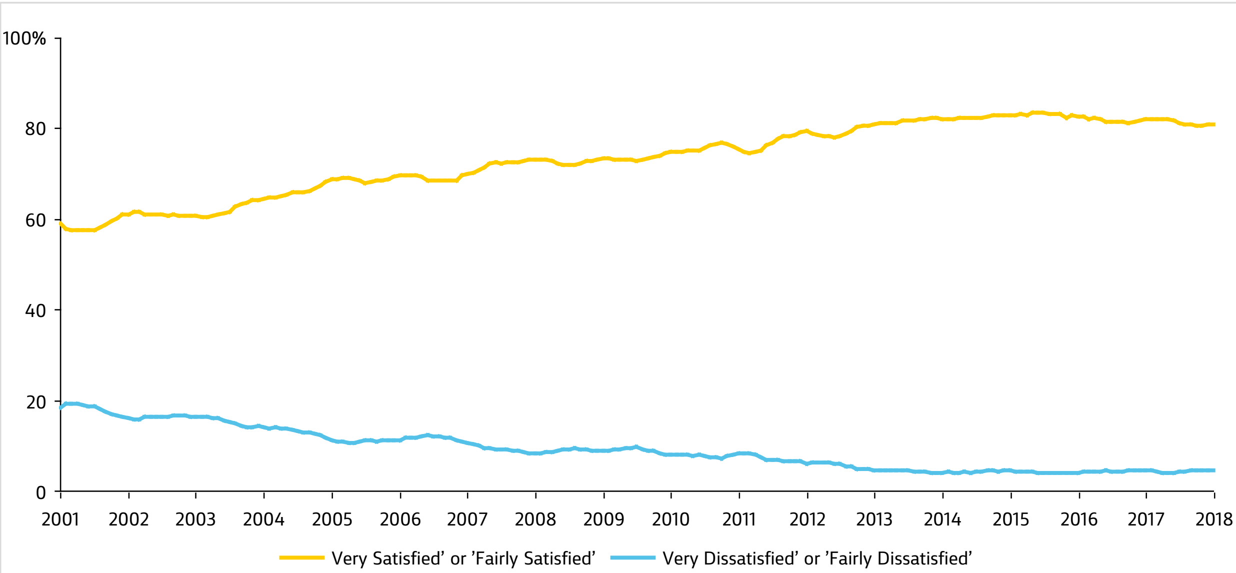
As a result of vigorous competition for customers, customer satisfaction is high, and has been increasing (refer Figure 1). As the figure shows, this has corresponded with declining customer dissatisfaction.

For example, from 2002 to 2018, 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 61.2% to 81.1%, with the proportion of dissatisfied respondents decreasing from 16.0% to 4.6%.

Similarly, in the seven years to January 2018, the proportion of business customers satisfied with their MFI increased by 2.7 percentage points (from 76.5% to 79.2%) with the proportion of dissatisfied customers decreasing by 2.9 percentage points (from 13.5% to 10.6%) [9].

CommBank is continually striving to better understand the needs of all customers' views, in particular by focusing on the individual concerns of dissatisfied customers.

Figure 1: Retail MFI customer satisfaction for Australia's Major Banks[10]



9 DBM Business Financial Services Monitor, Jan 2018, Satisfaction with MFI, percentage of respondents who scored 0-4 and 6-10. Selected MFIs comprise only of ANZ, NAB, WBC, and CommBank excluding Bankwest, and Regional Banks including Bendigo Bank, Bank of Queensland, Suncorp

10 Roy Morgan Research, Retail MFI Customer Satisfaction, Australian population 14 years+, 6 month rolling average to January 2018. Includes ANZ, CommBank excluding Bankwest, NAB and WBC 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

High levels of technological innovation are a key indicator of a highly competitive banking system. In addition to the world-leading digital banking solutions offered by Australian banks and the many other leading innovations by Australian banks, such as Lock, Block and Limit or Cardless Cash (refer to CommBank's initial submission to the Inquiry (Initial Submission) for detail), Australian customers have also benefited from global firsts in system innovation. Some world leading system innovations include BPAY, which was launched in 1997 as a single bill payment service across the industry, PEXA, the world's first digital settlement platform enabling digital registration and lodgement of property titles and real-time financial settlement, and the New Payments Platform (NPP), one of the world's first real time payments settlement platforms.

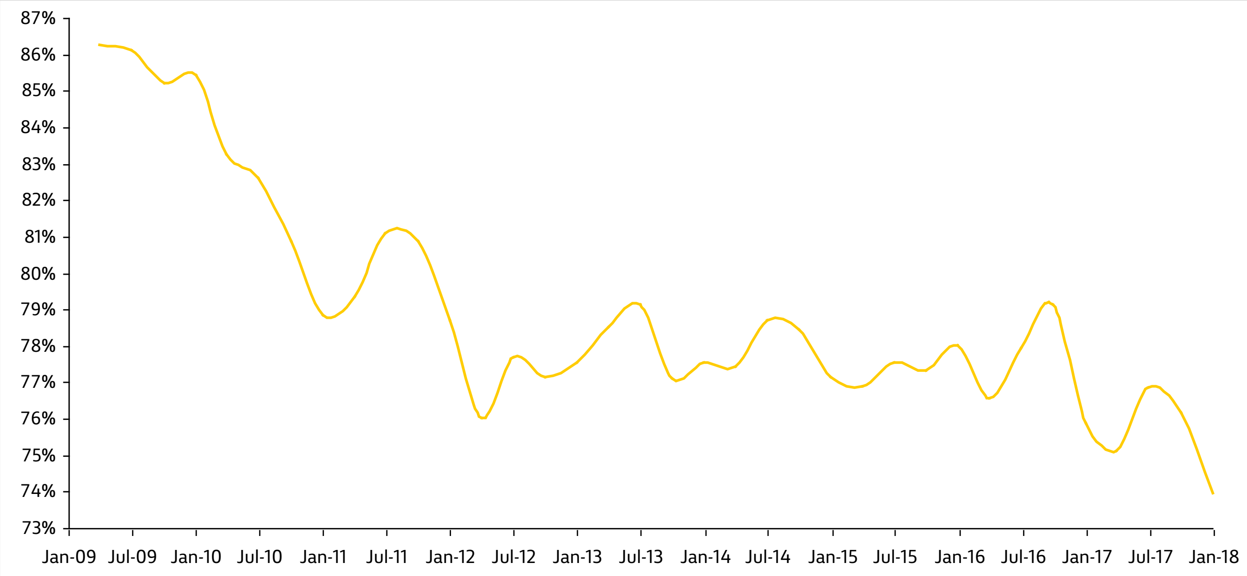
Further evidence of vigorous competition in the Australian financial system is the direct marketing spend per customer of Australia's Major Banks which is on par with global peers[11], and the substantial investment made each year by participants to maintain and improve their businesses. CommBank alone has invested over $1.2bn per annum on average over the last five years to improve and maintain its franchise.

The intensity of competition is also further evidenced by trends in the market shares of Australia's Major Banks in home loans. In this context it is important to recognise that (a) there is a long term declining market share trend for Australia's Major Banks; and (b) there is significant volatility in underlying month on month market share movements between competitors.

As noted by APRA in its initial submission to the Inquiry "In some cases, particularly for residential mortgage lending, the four major banks have lost market share to smaller entities. [...] the four major banks' share of mortgage approvals peaked at 86.3% in March 2009. By June 2017 this share had fallen to 76.9%, reflecting a gradual but consistent downward trend". This downward trend has since continued and the share of mortgage approvals of Australia's Major Banks was 74.0% in December 2017 (refer Figure 2 below).

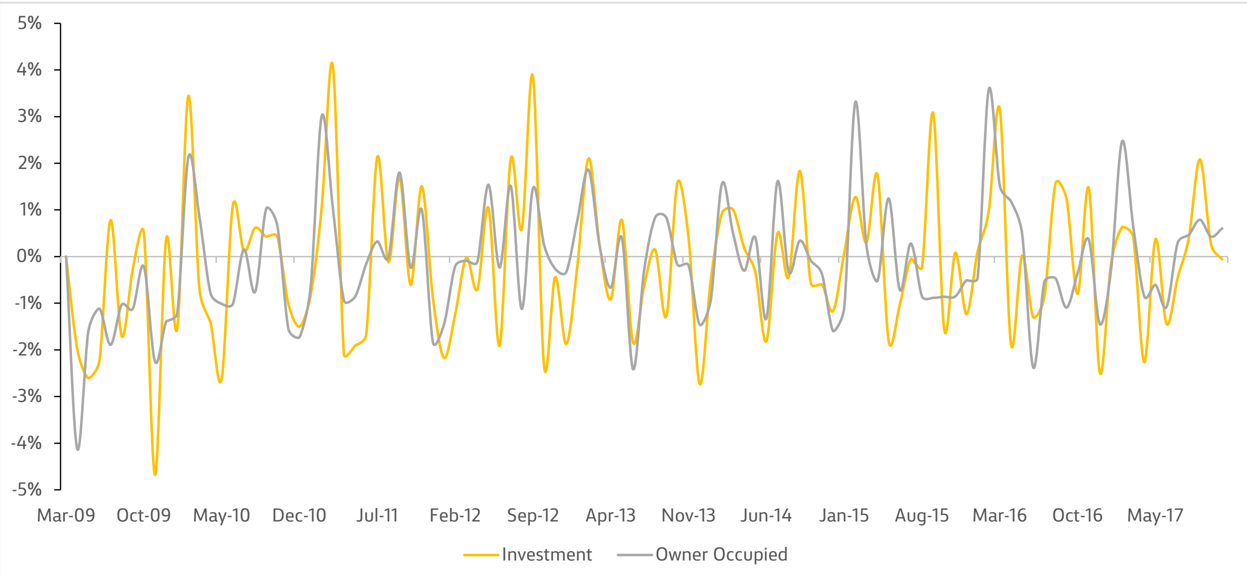
11 Boston Consulting Group, 2016, Retail Banking Excellence Benchmark, Australia's Major Banks median spend compared to global median spend

Figure 2: Market share of residential mortgage loans approved – Australia's Major Banks (%)[12]



Notwithstanding the long term declining market share trend for Australia's Major Banks in key products, of greater significance is the significant volatility in underlying month on month market share movements between competitors. CommBank's share of residential mortgage loans approved varies significantly month on month, demonstrating intense competition to win customers (refer Figure 3 below).

Figure 3: CommBank's share of residential mortgage loans approved – percentage point change month-to-month[13]



12 APRA, Quarterly Authorised Deposit-taking Institution Property Exposures -December 2017 (released 13 March 2018) www.apra.gov.au/adi/Publications/Pages/Quarterly-ADI-Property-Exposures-statistics.aspx
13 ABS for market data (5609 / 5671, November 2017), CommBank data

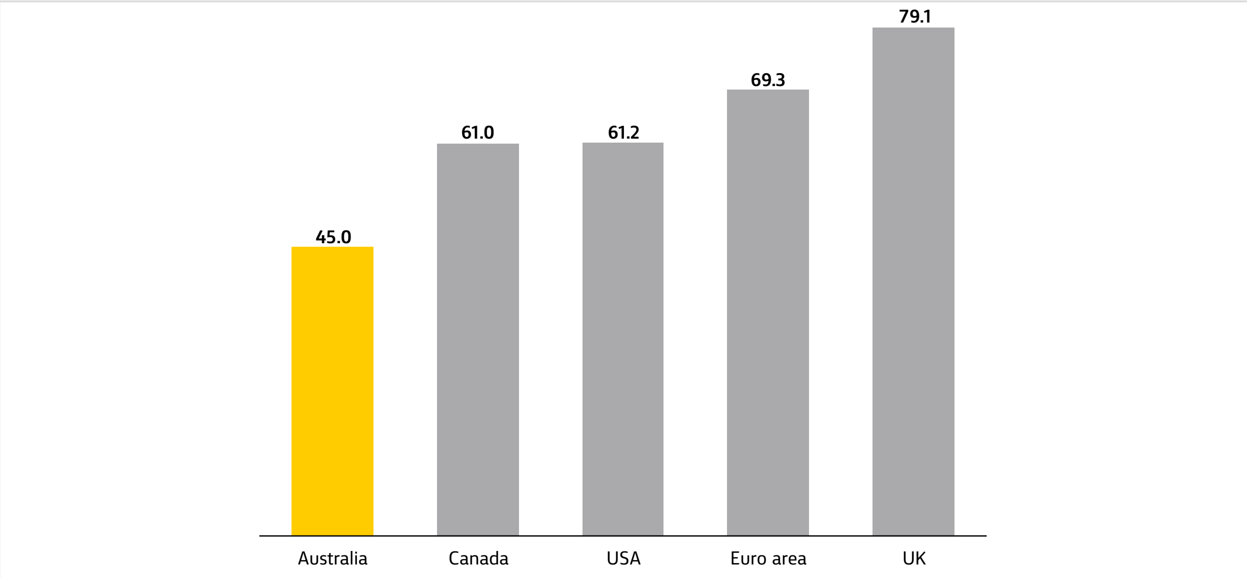
New market entrants and emerging business models have contributed to today's highly competitive financial services sector with numerous, diverse providers. In addition to Australia's Major Banks, customers can choose to meet their financial service needs through regional banks, credit unions and mutuals, 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.

In addition there is growing fragmentation of value chains and new entrants are building scale businesses in areas such as payments and home loan distribution.

The intensity of competition in Australia's financial system is also evidenced through the focus that Australian banks have had on being highly productive.

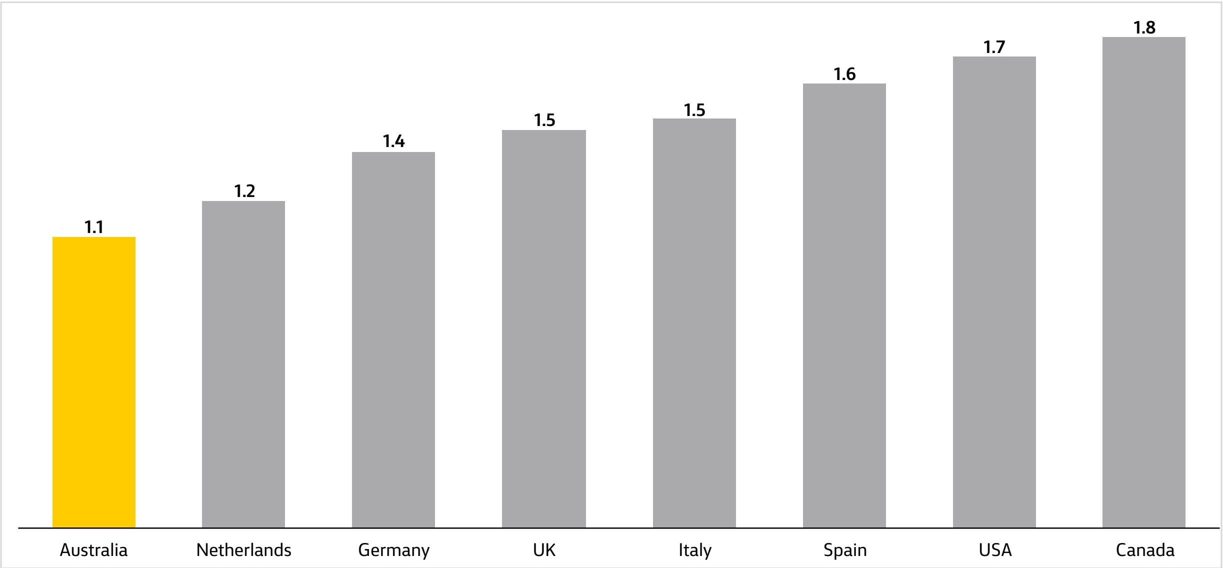
Australian banks are among the most efficient banks in the world, having a lower cost-to-income ratio, lower cost-to-asset ratio and lower operating expenses per customer[14] than in most comparable countries (refer Figures 4 and 5). This reflects ongoing investment in technology which boosts productivity as well as improving customer service levels and outcomes.

Figure 4: Large banks' cost-to-income ratios (%)[15]



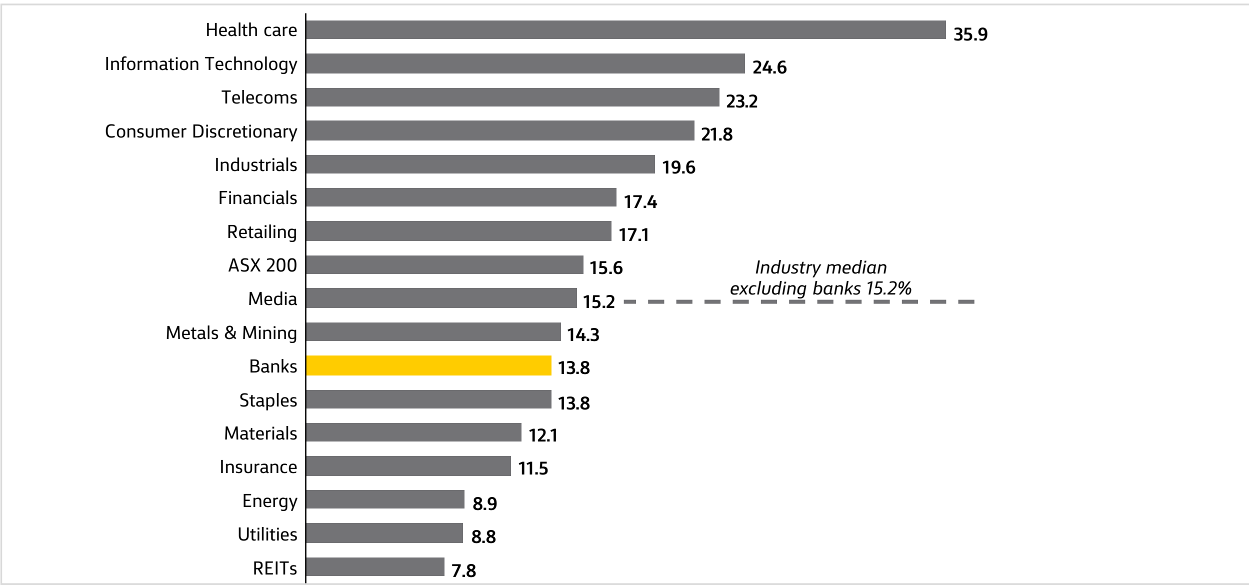
14 Boston Consulting Group, 2016, Retail Banking Excellence Benchmark (Australia's Major Banks have lower operating expenses per customer compared to the global median)
15 Bullock, M., 2017, Big banks and financial stability, delivered 21 July, available online: https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html (underlying source of graph: RBA; S&P Global Market Intelligence) Market share of the five largest banks

Figure 5: Banks' cost-to-asset ratios (%)[16]



As noted in CommBank's Initial Submission, 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. Despite this, it is worth noting that the ROE of the Australian banking industry is below the weighted average of ASX200 companies (refer Figure 6).

Figure 6: ROE across industry sectors in Australia (%)[17]



16 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
17 Credit Suisse

Australia's regulatory framework is superior to most mature markets. CommBank supports the clear division of accountability between the RBA, APRA and ASIC to ensure system stability, prudential supervision and customer protection respectively. CommBank also supports the role of the CFR to balance these objectives to ensure Australia's economic prosperity and the financial wellbeing of customers. The strength of this system has contributed greatly to the prosperity of the country as was evidenced by the strength of the Australian banks relative to banks in the USA, UK and other European countries when the GFC occurred. Unlike Australia, banking systems in those countries had been more highly deregulated to drive competition which led to unfavourable competitive activity and ultimately facilitated the GFC.

The strength of Australia's financial system regulation was recognised externally in November 2017 by the CEO of Standard & Poor's who noted that the regulations governing Australia's banks are amongst the strongest in the world[18].

Notwithstanding this, there have been a number of financial system policy developments in recent years, including new capital adequacy requirements for Authorised Deposit-taking Institutions (ADIs), the extension of APRA's powers with respect to provision of credit by non-ADI lenders, the development of a phased licensing approach for ADIs, ASIC's regulatory 'sandbox' and Future of Financial Advice (FOFA).

'Competition vs regulation' in the financial services industry and the role of capital have been debated across the globe. The Basel III and accounting standard reforms were a sweeping set of reforms designed to prevent bailing out of banks by governments and their taxpayers in the event of financial crises like the GFC.

In this regard, APRA's Chairman, Wayne Byres has often referred to the 'regulatory pendulum'. In his speech titled "Achieving a stable and competitive financial system", he mentioned the positive mutual reinforcement of competition and stability, rather than the opposition[19]:

> "*To borrow a phrase, we don't want 'the stability of a graveyard'. But we have all seen instances of excessive, or reckless, competition too. Eliminating the excess, and finding the optimum level of both, is a matter of careful balance. And, if we get the balance right, they will be mutually reinforcing: competition will support stability, and stability will support a competitive environment." […] "Much of the policy debate over recent years has been cast in terms of a trade-off between stability and competition in the financial system. We have never seen it that way, and were pleased that the FSI reached the same conclusion. Good regulatory settings can deliver financially strong competitors, creating both financial stability and a dynamic and innovative marketplace for financial services."*

CommBank reiterates that 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. Despite Australia being a relatively small economy, Australian financial services customers have access to world-leading propositions with high levels of choice, innovation, accessibility and service quality. Nonetheless, CommBank recognises that there will always be opportunities for the industry to continue improving customer outcomes.

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18 S&P, refer to AFR's article "Australian banks the best regulated in the world: S&P" (29/11/2017)

19 Wayne Byres, "Achieving a stable and competitive financial system", AFR Banking & Wealth Summit, Sydney, 29 April 2015

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. CommBank supports measures that promote vigorous competition and is unopposed to ***Draft Recommendation 7.2 (Building an evidence base on integration)***.

1.2 Australia's economic prosperity relies on a strong and stable financial system

Key Points

- Economies of scale are a primary driver of the profitability of Australia's Major Banks relative to other Australian banks.
- Although Australia's Major Banks experience a lower cost of funding, the relativity between their cost of funding and that of other Australian banks has been contracting over time.
- The sophistication in risk systems from banks investing to attain internal ratings-based (IRB) accreditation provides a benefit for financial system stability, investors and deposit holders.
- The structure of Australia's financial system in terms of market concentration is similar to other countries which are comparable to Australia.
- Australia's reliance on offshore funding to fund the current account deficit means that Australia needs large, strong banks with good credit ratings to access global wholesale funding markets at scale.
- Systemic failures stemming from weakened prudential regulation / absence of "unquestionably strong" banks typically result in catastrophic fiscal and socio-economic outcomes.

Summary of Response to Draft Findings

- CommBank rejects ***Draft Finding 5.1 (Cost of funds for different size banks*).**
- CommBank rejects ***Draft Finding 3.1 (The major banks' oligopoly power)*.**
- CommBank accepts ***Draft Finding 4.1 (A consolidation in banking).***
- CommBank rejects ***Draft Finding 16.1 (Ratings agencies exacerbate the perception of 'too big to fail')*.**
- CommBank rejects ***Draft Finding 16.2 (The Four Pillars policy is redundant*).**

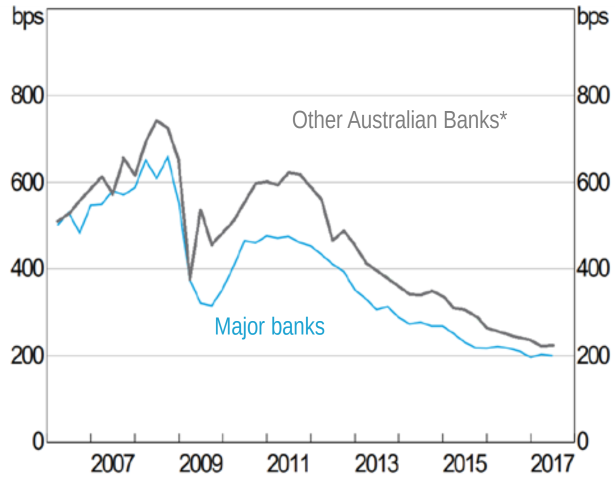
A primary driver of profitability of Australia's Major Banks compared to other Australian banks is economies of scale. As outlined later in this chapter, Australia's reliance on offshore funding means that Australia needs large, strong banks with good credit ratings to access global wholesale funding markets at scale.

CommBank rejects ***Draft Finding 5.1 (Cost of funds for different size banks***). It is important that Australian banks are profitable and that they have a positive outlook when competing for the lowest cost, and potentially scarce, funding. Australia's Major Banks have traditionally experienced a lower cost of funding compared to the other Australian banks. The lower cost of funding is function of the following key factors:

- Strong credit ratings (a function of diversity of income, scale of operations, confidence of investors, history of successful execution of business strategy, prudent liquidity, funding and capital management, and external conditions such as system stability);
- Ability to access diverse sources of funds, including international capital markets; and
- Competitive deposit pricing.

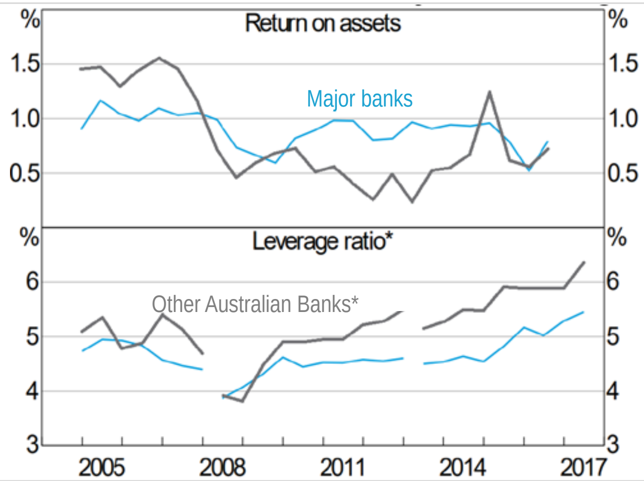
However, it should be noted that whilst Australia's Major Banks experience a lower level cost of funding, the relativity between Australia's Major Banks and the other Australian banks cost of funding has been contracting since the shock of the GFC (refer Figure 7).

Figure 7: Banks' Debt Funding Costs[20]



In general, Australia's Major Banks proportionally hold less capital for the same assets compared to the smaller banks. This capital efficiency is partly due to the fact that Australia's Major Banks (and Macquarie Bank, as well as ING Bank (Australia) from 1 April 2018) are permitted to use the IRB approach to credit risk to determine their capital requirements. The IRB approach allows banks to use their own internal assessment of risk to determine the risk-weighting for loans and is a more risk sensitive measure than the standardised approach that is used by the smaller banks. The resultant impact of this is that Australia's Major Banks have been able to operate with a proportionally lower level of capital (refer Figure 8).

Figure 8: Australian Banks' Profitability and Leverage[21]



20 APRA, RBA. Quarterly, by type. *Selected non-major banks.
21 APRA. Leverage Ratio denotes Tier 1 capital as a share of total assets. Break in March 2008 due to the introduction of Basel II; break in March 2013 due to introduction of Basel III.

The IRB approach is available to all banks but in order to use it, a bank must be accredited by APRA. To obtain accreditation, a bank must demonstrate that its internal models can produce reliable, risk-sensitive, and comparable estimates of the capital required at the predetermined soundness standards. Significant investments have been made and are required on an on-going basis for Australia's Major Banks to achieve and maintain their IRB accreditation.

The reduced capital required by the IRB accreditation is regarded as a strong incentive for banks to continue increasing the sophistication of risk systems. Such sophistication in risk systems provides a benefit for institutional financial stability, investors and deposit holders.

However, the relative benefit from IRB accreditation has reduced in recent years given the recent regulatory changes imposed by APRA have required Australia's Major Banks to materially increase their capital levels[22]. In addition, ING Bank (Australia) received IRB accreditation from APRA on 19 March 2018[23], and CommBank understands that several other non-IRB accredited banks are currently going through the accreditation process with APRA.

CommBank rejects ***Draft Finding 3.1 (The major banks' oligopoly power)*** and would note that concentration with a given market is not, per se, an indication of the degree of competition in a market.

Notwithstanding this, concentration levels in Australia are comparable to other relevant countries, particularly when compared to the size of the economy. As the RBA has noted, Australia is by no means unique when it comes to the concentration of the banking sector. Among advanced economies, the market share of Australia's largest five banks is comparable to that of the Netherlands, Sweden and Canada[24]. By global standards, the level of concentration is consistent with the size of the population (refer Figure 9).

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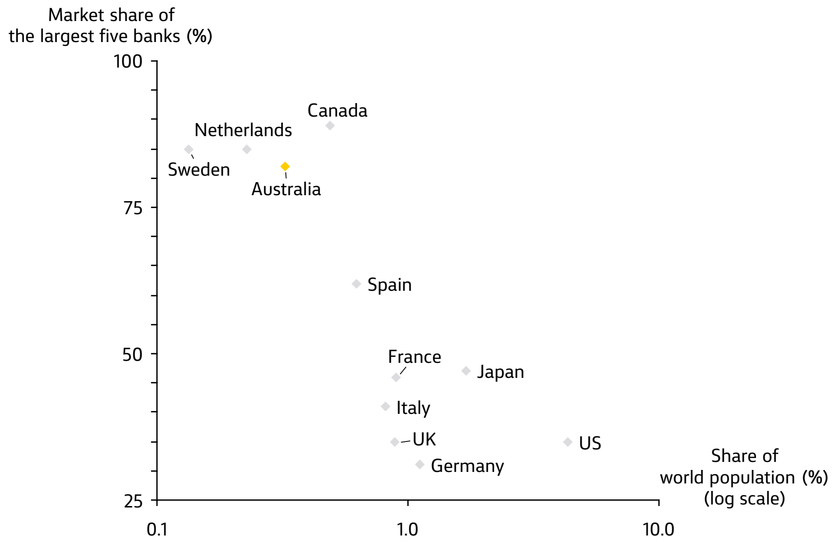
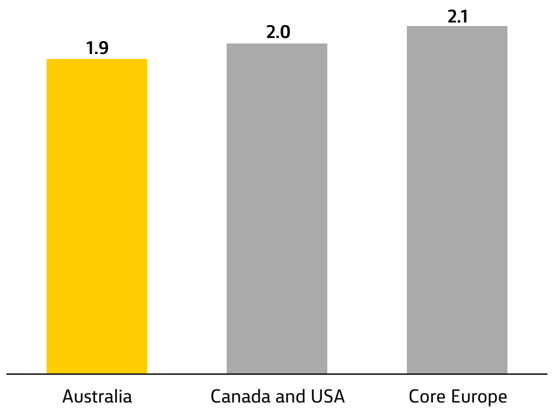
22 APRA, 2017, Information Paper: Strengthening banking system resilience – establishing unquestionably strong capital ratios, available online at:
www.apra.gov.au/adi/Documents/Unquestionably%20Strong%20Information%20Paper.pdf
23 APRA announcement 19 March 2018
24 RBA, "Big Banks and Financial Stability", July 2017, https://www.rba.gov.au/speeches/2017/sp-ag-2017-07-21.html

Figure 9: Relationship between financial system concentration and population size[25]



In addition, 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 (refer Figure 10).

Figure 10: Number of Banking Relationships per consumer[26]



CommBank accepts ***Draft Finding 4.1 (A consolidation in banking)*** however would note that although the GFC led to a significant rationalisation of ADIs, with the number declining by 80 over the 10 years to 2016[27], much of this change was a result of credit unions and building societies merging and/or becoming banks. This corresponded with a rise in the number of banks, with banks now the most common type of ADI.

If Australia's banks (particularly Australia's Major Banks) were to operate at a lower level of profitability, this could negatively affect their credit ratings as profitability and capital generation is one of the key factors considered by rating agencies in their assessment of credit ratings. A lower credit

25 The World Bank, 2016, https://data.worldbank.org/indicator/SP.POP.TOTL /
26 McKinsey, 2016, Retail Banking Consumer Survey; Australia Personal Financial Services Survey 2014
27 APRA, Quarterly Authorised Deposit-taking Institution performance, available online at: www.apra.gov.au/adi/Publications/Pages/adi-quarterly-performance-statistics.aspx

rating would result in either an increase in the cost of funding and/or a reduction in the level of capital imported into the Australian economy by banks.

This is an important consideration for Australia because the contribution of banks to facilitating private sector growth in the economy is higher than most other mature markets[28]. To put this in context, Australia's Major Banks alone raised almost $100bn of long term wholesale funding in offshore markets in FY17[29]. During this period, to enable it to provide $135bn in new lending to Australian customers, CommBank raised $27bn offshore in long term wholesale funding and renewed approximately $32bn offshore in short term wholesale funding on average each month.

This ability to access offshore markets at scale and to fund Australia's current account deficit, both in normal and stressed macro-economic conditions, is critical to the prosperity of the Australian economy. This takes on greater importance as regulators increase focus on net stable funding ratios.

It is also critical that Australia's Major Banks are sufficiently profitable in order to generate capital (through retained earnings) to absorb losses. A consequence of insufficient profitability is lower organic capital generation, which in turn results in a possible constraint on the growth of balance sheets and limits the ability to absorb losses.

To bring this to point to life, industry Loan Impairment Expenses (LIE) are currently at historical lows which is reflective of this point in the economic cycle. If all other things remained equal and CommBank's LIE was to increase to a level experienced by the UK banks during the GFC, it would likely result in a negative Return on Equity (ROE) for CommBank[30].

Systemic failures stemming from weakened prudential regulation or the absence of "unquestionably strong" banks typically result in catastrophic fiscal and socio-economic outcomes, as recently demonstrated by the impact of the GFC on many advanced economies. While bank bail-outs by governments represent a direct fiscal cost, disruption of the banking sector typically also results in indirect costs such as a reduction in the availability of credit to consumers and businesses and weakening demand in the economy[31]. As banking crises may not occur in isolation, it is difficult to separate indirect costs attributable to bank failure from the impact of economic conditions that resulted in bank failure, for example a reduction in export demand. Regardless, the size of such costs may be considerable compared to the direct bail-out costs (refer Figure 11).

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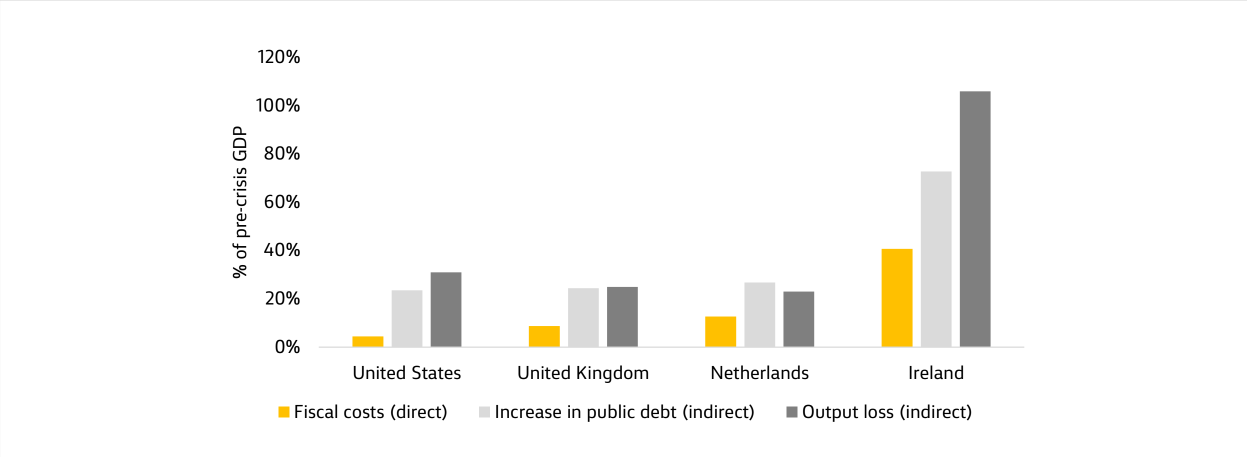
28 Bank for International Settlements, June 2017, Database: Credit to the non-financial sector, available online at: www.bis.org/statistics/totcredit.htm
29 Australian Major Banks' annual reports. Note: CommBank has a Jun-17 year end. WBC, NAB and ANZ have a Sep-17 year end.
30 High level internal estimate based on LIE levels experienced in UK market during GFC (UK FY09 Peak average 258 bps)
31 Frontier Economics

Figure 11: Direct and indirect costs of banking crises during the GFC[32]



Banking failures in the Republic of Ireland and the Netherlands resulted in large direct fiscal costs, owing to the cost of government support for failing banks, in addition to substantial increases in public debt and output loss that may be attributed to the bank failures (and the GFC in general). The systemic failures in the USA and UK also resulted in significant direct and indirect costs to these economies.

CommBank rejects ***Draft Finding 16.1 (Ratings agencies exacerbate the perception of 'too big to fail')***. Australia's Major Banks have an advantage in accessing capital markets by virtue of their credit ratings relative to smaller banks. This reflects the fundamental characteristics, such as size, ability to manage risk and balance sheet strength, and the probability of Government support in times of stress. General Government support for the whole banking industry is important, and is critical in periods of stress. It is worth noting that there is a difference between an implicit Government guarantee for particular banks and general Government support for all banks. As demonstrated during the GFC, the Government provided support to all banks.

Governments and central banks have long been recognised as lenders of last resort to the banking sector. Guaranteeing the debt of banks to enable them continued access to capital markets is an indirect way of fulfilling this role, and the precise nature of the guarantee does not need to be determined until the time it is needed, when the risk can be better judged. While ratings agencies each hold similar expectations of Government support, they differ in their assessment of the associated ratings uplift from the expected support. The views of ratings agencies and capital markets persist despite the absence of direct policies or statements from the Government on the matter. However, the Government's conduct in the wake of the GFC demonstrated that it has an appetite to support all banks.

Quantifying the extent of any funding advantage from the uplift in credit ratings is complex[33]. The size of a bank can affect perceptions of its creditworthiness but size is also part of the ratings agencies' belief that Government support will be provided in a crisis. The RBA indicates that the funding advantage rises and falls over time. For example, the funding advantage for Australia's Major Banks

32 Laeven and Valencia, "Systemic Banking Crises Database: An Update", International Monetary Fund Working Paper 12/163, 2012
33 RBA – implicit guarantee for banks, available online at: https://www.rba.gov.au/information/foi/disclosure-log/pdf/151609.pdf

was estimated to have fallen to around 10 basis points in late 2014 (a time of relative stability for financial markets and the financial system) whereas there are estimates of a 120 basis point advantage in 2009 (a time of heightened instability for financial markets and the financial system).

CommBank acknowledges that the funding advantage for Domestic Systemically Important Banks (versus smaller banks) can become material in times of heightened instability for financial markets. However, from a competition perspective it is not wise to attempt to nullify advantages that derive from good business practices and fundamental differences in risk to the stability of the financial system.

If the Government is to address the effects of a perceived "implicit guarantee" for Australia's Major Banks, the best way to minimise the impact would be to continue to increase the resilience of the financial system, as recommended by the Financial System Inquiry (FSI).

CommBank rejects ***Draft Finding 16.2 (The Four Pillars policy is redundant***). As indicated in CommBank's FSI response, it continues to support the Four Pillars policy, which operates to prevent a merger between any of the large banks, reflecting a decision by the Government to prevent further consolidation in the market.

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1.3 The performance of the industry reflects the operating context

Key Points

- Australia's unprecedented period of economic prosperity has underpinned the strong performance of the Australian financial system relative to the UK, USA and Europe.
- Australia will experience a recession at some point in the future and this will have a negative impact on the profitability of Australia's banks and test the resilience of Australia's financial system.
- While Australia's Major Banks have better economies of scale than other Australian banks, the difference in ROE has been steadily declining since the GFC.
- Any evaluation of the state of competition must recognise the complex nature of interdependencies that govern the economics, stability, and safety of the financial system.

Summary of Response to Draft Findings

- CommBank rejects **Draft Finding II.1 (State of competition in the financial system).**

When compared to international peers in the USA, UK and Europe since the GFC, Australia's banks have been relatively more profitable, partly reflecting the unprecedented period of uninterrupted economic growth in Australia and the continued strength of the housing sector in Australia.

One of the drivers of Australia's outperformance is the simpler asset mix of the Australian banks. Returns for Australian and Canadian banks, which have comparatively simple structures, or lower exposure to trading and institutional banking, have been higher than most other jurisdictions since the crisis[34].

The GFC severely damaged major economies across the world, yet Australia proved resilient. Despite higher unemployment and slow economic growth, Australia did not suffer a large financial crisis. There were several reasons for the resilience of the Australian economy during the GFC. The RBA typically refers to the following[35]:

- Australian banks had limited exposure to the USA housing market and USA banks;
- Australian banks had pursued limited high risk / subprime lending in Australia;
- The resource boom, including exports to China whose economy rebounded quickly from the GFC; and
- Policy response: the RBA lowered the cash rate substantially, and the Government undertook expansionary policy while providing support for deposits and bonds issues by the banking sector.

At some point in the future, Australia will experience a recession. When this happens, Australia's regulatory settings must ensure that the financial system has the strength and stability to absorb losses and support economic recovery. Whilst Australia's financial system was not as impacted by the

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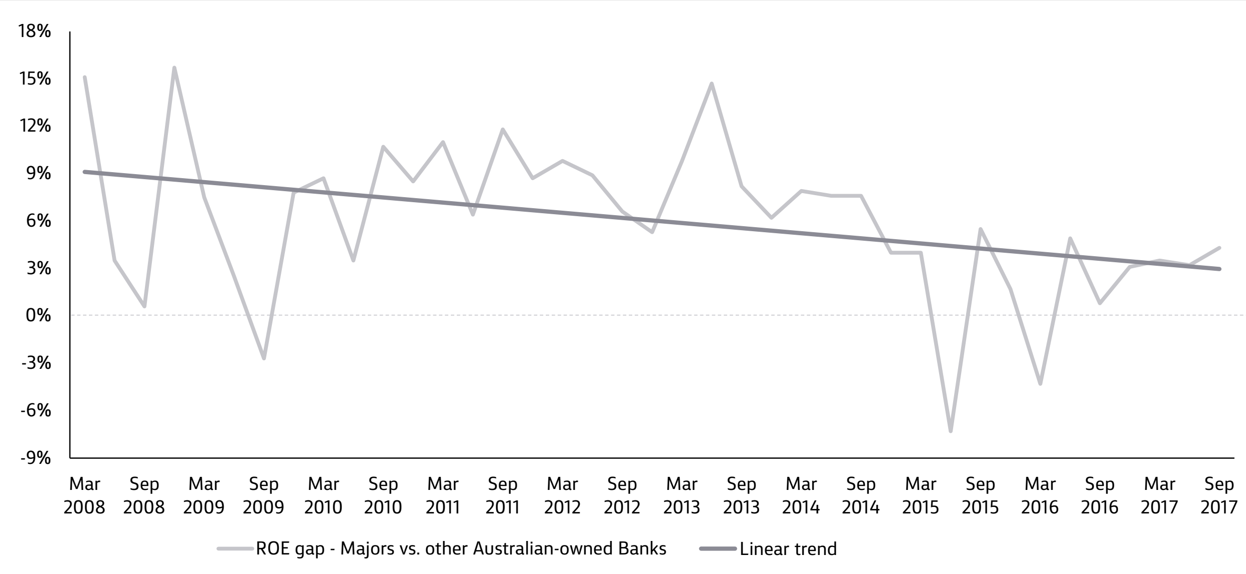
34 RBA, initial submission, page 11
35 https://www.rba.gov.au/education/resources/explainers/pdf/the-global-financial-crisis.pdf?v=2018-03-15-20-14-42

GFC as many other countries' financial systems, the factors that helped protect Australia's economy then (such as persistent demand for commodity exports and interest rates that were sufficiently high to enable expansionary monetary policy) are unlikely to exist, at least to the same extent, entering into the next downturn.

As a result of the financial system shock created by the GFC, the ROE of Australia's Major Banks was higher than other Australian banks for a period of time however, this gap has narrowed significantly over the period and is now approximately 4% (refer Figure 12). This has been primarily due to an increase in capital requirements for Australia's Major Banks and, as credit spreads for the non-major banks have decreased over time, an improvement in the Net Interest Margin (NIM) of the other Australian banks.

Figure 12: ROE gap - Majors vs. other Australian-owned Banks[36]



As APRA has pointed out in its initial submission to the Inquiry, average ADI ROE for the 12 months to 30 June 2017 was 11.7%, below the 10 year average of 13.4% (which itself has declined in recent years). This should be considered in the context of Australia's unprecedented period of economic prosperity and industry LIE being at historically low levels. As noted earlier, if all other things remained equal and CommBank's LIE was to increase to a level experienced by the UK banks during the GFC, it would likely result in a negative ROE for CommBank.

In response to the Commission's assertions presented during the Inquiry's public hearings that the NIM of Australia's Major Banks has remained stable for several years, and that "major banks have the ability to pass on cost increases and set prices that maintain high levels of profitability", CommBank notes the following for consideration:

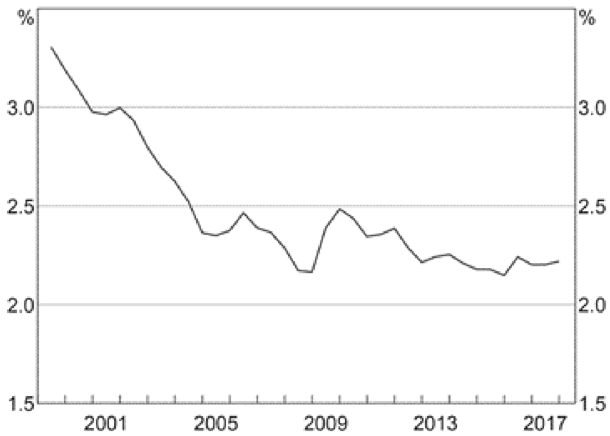
- The NIMs of Australia's Major Banks has been trending down consistently for over 20 years (refer Figure 13).
- NIM measures only a subset of profitability. A more comprehensive measure of profitability is ROE as this accounts for NIM and all other costs and incomes, for example, operating expenses, LIE, other (non-interest) income, etc. One example of this is the relative decline in

36 APRA Quarterly Authorised Deposit-taking Institution Performance, December 2017 (released 13 March 2018)

fees which have benefited customers in recent years that would not be reflected in NIM (refer Figure 14).

- As noted earlier, industry ROEs, particularly the ROEs of Australia's Major Banks, have declined in recent years. This fall in profitability is evidence that Australia's Major Banks cannot simply "pass on cost increases and set prices that maintain high levels of profitability" and that competition is vigorous.
- Cost of funding is not determined only by the RBA's Official Cash Rate. Whilst there is some correlation, off-shore funding markets also have a significant influence on cost of funding. Figure 15 shows the cost of funding spread for CommBank and how this is not highly correlated to the RBA's Official Cash Rate. This chart also shows how CommBank's spread has declined since the GFC.
- Larger banks benefit from the economies of scale in operating costs and funding costs and thus, all other things being equal, one would expect Australia's Major Banks to be more profitable than the other Australian banks in an effective and competitive market.

Figure 13: Australia's Major Banks' Net Interest Margin[37]



37 RBA, Bank financial reports, domestic, half yearly. From 2006 data on IFRS basis; prior years on AGAAP. Excludes St George Bank and Bankwest prior to the first half of 2009.

Figure 14: Banking Fees in Australia[38]

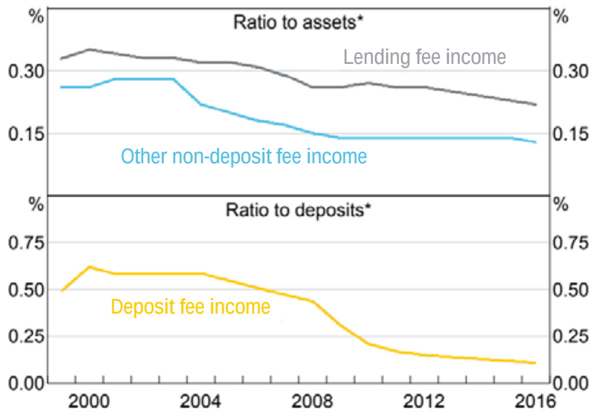
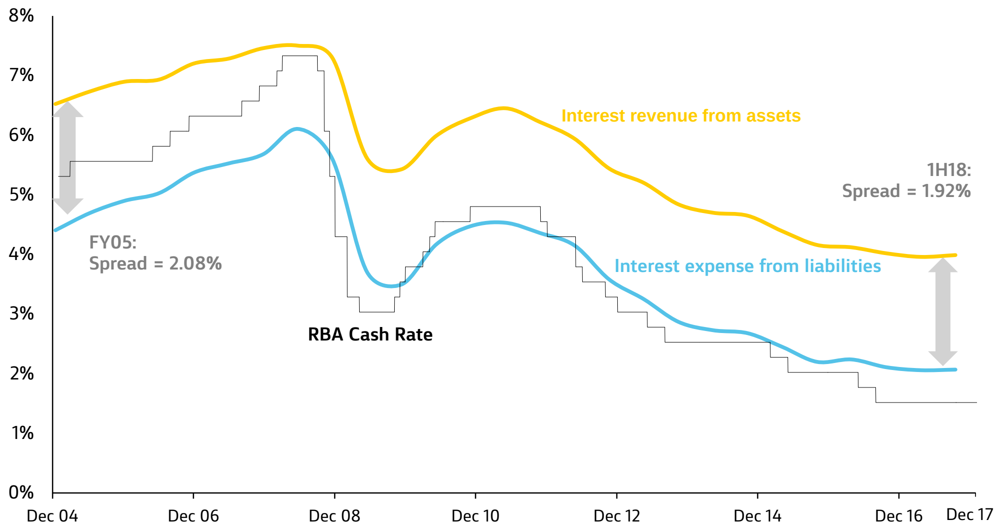


Figure 15: CommBank's funding costs vs RBA Cash Rate[39]



An evaluation of the state of competition in the industry must recognise the complex interdependencies between all the considerations raised in this chapter. On balance, CommBank rejects ***Draft Finding II.1 (State of competition in the financial system)***.

38 RBA, June 2017, Domestic banking fee income, available online at: https://www.rba.gov.au/publications/bulletin/2017/jun/pdf/bu-0617-4-banking-fees-in-australia.pdf. Adjusted for breaks in series in 2002 due to a change in banks' reporting; financial-year average assets and deposits have been used.
39 RBA, Cash Rate available online at: https://www.rba.gov.au/statistics/cash-rate/

Chapter 2: Balancing competition and stability for economic prosperity

2.1 Change in regulators' roles and responsibilities

Key Points

- Australia has a robust regulatory framework.
- Financial system stability should be a primary aim of policy, whilst also ensuring customers are protected, and promoting competition. Design of regulation must be guided by "through the cycle" implications.
- CommBank supports in principle the need for a regulator to be mindful of competition outcomes and notes the Minister for Revenue and Financial Services' announcement of ASIC's new competition mandate (19 March 2018).

Summary of Response to Draft Recommendations

- CommBank supports in principle ***Draft Recommendation 15.1 (Statements of expectations for regulators)***.
- CommBank supports in principle ***Draft Recommendation 17.1 (New competition functions for a regulator)***, however urges caution and further consultation with regulators in relation to a number of features of the proposal.
- CommBank supports in principle ***Draft Recommendation 17.2 (Transparency of regulatory decision making)***, but urges caution and has concerns regarding the delays to regulatory decisions and/or confidentiality considerations.
- CommBank supports in principle ***Draft Recommendation 17.3 (Robust and transparent analysis of macro-prudential policies)***, but urges caution and has concerns regarding the delays to regulatory decisions and/or confidentiality considerations.

Summary of Response to Draft Findings

- CommBank notes ***Draft Finding 2.2 (Competition and stability must co-exist).***
- CommBank rejects ***Draft Finding 6.1 (Cost of APRA interventions on home loans)***.
- CommBank notes ***Draft Finding 15.1 (APRA not well placed to consider competition in the financial system)***. CommBank notes that the Commission's draft report proposes the CFR to assess the competition related implications of regulation. As a member of CFR, APRA would be involved in this process.

CommBank 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. Indeed, in November last year the international ratings agency S&P Global Ratings said that the existing laws and regulations governing Australia's banks are the amongst strongest in the world[40].

CommBank reiterates Recommendation 4 of its Initial Submission that any regulation designed to stimulate competition should give consideration to "through the cycle" implications, in particular the potential risks to customer protection, market integrity and/or financial system stability in the event of an economic downturn or period of economic volatility.

CommBank also takes this opportunity to reiterate the importance of maintaining financial system stability as the primary aim of policy, whilst also ensuring customers are protected and competition is promoted for the benefit of customers. Systemic failures have led to materially adverse outcomes for the broader economy in other countries such as Ireland and the UK, with broad fiscal and socio-economic impacts.

As such, CommBank notes ***Draft Finding 2.2 (Competition and stability must co-exist)***, but notes that financial system stability, and the perception thereof, should remain of primary importance for policy and supervision in financial services. Where there is a conflict or any doubt between financial stability and other considerations such as competition, it is critical that stability should prevail in those circumstances.

CommBank supports in principle ***Draft Recommendation 15.1 (Statements of expectations for regulators).*** As stated in its submission to the FSI, CommBank has already supported the use of these statements to establish principles or boundaries around which regulation is formed. CommBank also notes that the Minister for Revenue and Financial Services announced that the Government has settled on the new statement of expectations for ASIC (19 March 2018).

CommBank believes a regulator's statement of expectations should ensure that future regulation should be guided by its "through the cycle" implications. CommBank also supports Statements of Intent to be published by regulators as a matter of good practice (however further consideration should be given to the proposed three month time period). CommBank supports in principle the need for regulators to provide in their annual reports the actions they are taking in line with Statements of Intent. However, CommBank also recognises that there might be some specific decisions / actions taken by regulators that might need to remain confidential for an extended period of time. CommBank believes that regulators are in a better position to comment on such circumstances.

CommBank supports in principle ***Draft Recommendation 17.1 (New competition functions for a regulator).*** As noted above, CommBank supports in principle the recommendation that regulator Statements of Expectations are updated and Statements of Intent are published by regulators. CommBank supports in principle the need for regulators to be more mindful of competition outcomes.

However, CommBank urges caution and further consultation with the regulators in relation to the following proposal raised by the Commission: "[including] transparent analysis of competition impacts to be tabled in advance of measures proposed by regulators" - some regulatory decisions need to be made quickly in order to preserve financial stability, consumer outcomes or market integrity. Examples could include recovery and resolution interventions, bailouts, and short selling prohibitions. CommBank also does not support the creation of any significant regulatory uncertainty where industry may be required to immediately respond to regulatory measures only to subsequently be asked to unwind this response after a competitive assessment requiring transparency (such as in Draft

40 S&P, refer to AFR's article "Australian banks the best regulated in the world: S&P" (29/11/2017)

Recommendation 17.2) over all regulatory decisions. As mentioned above, CommBank recognises that there might be some specific decisions / actions taken by regulators that might need to remain confidential and for an extended period of time.

CommBank supports in principle ***Draft Recommendation 17.2 (Transparency of regulatory decision making)***, but urges caution. Indeed, some additional transparency around the CFR's deliberations and decision making process would provide industry with useful insights into regulators' expectations and intentions. However, as noted above, CommBank has concerns regarding the delays to regulatory decisions and/or confidentiality considerations. CommBank believes that its regulators are in a better position to provide a more comprehensive view on the specific considerations of such challenges.

CommBank supports in principle ***Draft Recommendation 17.3 (Robust and transparent analysis of macro-prudential policies)***. However, CommBank would welcome clarity as to which prudential regulatory decisions / actions the Commission considers to be potential areas of 'macro-prudential policies' and thereby subject to the Commission's proposal to ensure 'robust and transparent analysis'. As stated above, CommBank has some concerns regarding delays to regulatory decisions and/or confidentiality considerations. For example, the future requirement to review a decision annually and publicly may result in the regulators taking a slower approach to their decision making in situations where a swifter approach is necessary.

Provided this concern is addressed, CommBank welcomes ***Draft Recommendation 17.3*** (***Robust and transparent analysis of macro-prudential policies)*** in principle. More generally, it is important that APRA continues to clearly articulate the intent of proposed macro-prudential policies, consults widely and evaluates the outcomes.

CommBank rejects ***Draft Finding 6.1 (Cost of APRA interventions on home loans***) (i.e. assertion that "competition between lenders was restricted, and there was limited competitive variation in lenders' responses to the regulatory intervention)**.** These changes were made to help meet CommBank's regulatory requirements, specifically APRA's requirement that interest only lending not be more than 30% of total new business. CommBank's first step in response to the APRA limit was to change its lending policies and to reduce discretionary discounts on new interest only lending. CommBank reduced these to the lowest level possible, while leaving its headline rates unchanged. Subsequently, CommBank's competitors announced increases in their headline interest only rates. Consequently, CommBank's interest only product was the cheapest of all of Australia's Major Banks. If this situation had continued, CommBank anticipated breaching the APRA cap as CommBank would have attracted more volume. Because CommBank had already reduced its discretionary discounts, the only option left was to change its headline interest only rates to avoid breaching the APRA 30% limit. As the headline rate is the same 'reference rate' for both new and existing customers, raising CommBank's headline rate impacted both new and existing customers.

CommBank notes ***Draft Finding 15.1 (APRA not well placed to consider competition in the financial system)*****.** CommBank notes that the Commission's draft report proposes the CFR to assess the competition related implications of regulation. As a member of CFR, APRA would be involved in this process.

Response to Information Requests

Information Request 17.1 Which regulator should advance competition in the financial system?

- CommBank notes the Minister for Revenue and Financial Services' announcement of ASIC's new competition mandate (19 March 2018).

2.2 Balancing macro-prudential regulation

Key Points

- CommBank is supportive of more finely calibrating the risk weights to better reflect the risk inherent to specific segments, as long as these calibrations are in line with the Basel Framework and are appropriate in the context of the Australian financial system.
- There is currently a level playing field for all ADIs as the IRB approach is currently available to all banks, subject to demonstrated ability to meet the appropriate risk evaluation standards set by APRA.
- Removing the incentive for banks to attain IRB accreditation could result in less sensitive risk measurement and poor pricing outcomes for customers.

Summary of Response to Draft Recommendations

- CommBank is unopposed to ***Draft Recommendation 7.1 (A proportionate approach to risks non-ADIs pose)***.
- CommBank supports in principle ***Draft Recommendation 9.1 (Standardised risk weightings for SME lending)***.
- CommBank supports in principle ***Draft Recommendation 16.1 (Review standardised risk weights for residential mortgages)***.

Summary of Response to Draft Findings

- CommBank accepts ***Draft Finding 7.2 (New rules costly for non-ADIs)***.

Risk weights

Australia's Major Banks, Macquarie Bank and ING Bank (Australia) (from 1 April 2018) have had their IRB models approved by APRA, allowing them to utilise a greater degree of granularity in risk weights than ADIs using the standardised approach. While it is true that risk weights for IRB residential mortgage lending are lower than that of standardised ADIs, it is also true that IRB risk lending for riskier IRB lending (such as unsecured personal loans) require higher risk weights than that of standardised ADIs.

CommBank's view is that there is currently a level playing field for all ADIs. The IRB approach is currently available to all banks, subject to accreditation by APRA i.e. a bank must demonstrate that the bank's internal models can produce reliable, risk-sensitive, and comparable estimates of the capital required at the predetermined soundness standards.

This incentivises all ADIs to invest in these capabilities as it provides ADIs a greater risk-sensitivity and in general allows these ADIs to operate with a more efficient capital structure.

Australia's Major Banks have made, and continue to make, significant investments on an on-going basis to achieve and maintain their IRB accreditation. Removing the incentive for banks to use the IRB approach could result in reduced risk measurement and poor risk and price outcomes for all stakeholders (including customers).

On 14 February 2018, APRA released a discussion paper on its proposed revisions to the existing capital framework. The papers include revisions to the capital framework resulting from the Basel Committee finalising the Basel III reforms (also referred to as 'Basel IV') in December 2017, and also includes proposals to address the systemic concentration of bank portfolios in residential mortgage lending by seeking to target higher risk residential mortgage lending (for example investment and interest only loans).

In general, the proposed revisions to the standardised approach are intended to provide a more risk-sensitive approach. One of the changes that is proposed by APRA is a revision to the current risk-weighting applied to mortgages calculated on a standardised approach, where there is more granular risk-weighting for mortgages with a Loan to Value Ratio (LVR) <80% (current framework applies a flat 35% risk-weighting).

The review also contains a proposal to introduce a risk-weighted asset floor for banks using internal models of at least 72.5% of standardised risk-weighted assets. The capital floor will limit the variation in capital requirements between banks that are IRB accredited and those utilising the standardised approach.

CommBank is in favour of more finely calibrating risk weights to better reflect the risk inherent to specific segments, as long as these calibrations are in line with the Basel Committee's minimum risk weight and credit conversion factor recommendations. As such, CommBank supports in principle ***Draft Recommendation 9.1 (Standardised risk weightings for SME lending)*** and ***Draft Recommendation 16.1 (Review standardised risk weights for residential mortgages)***. In APRA's discussion paper "Revisions to the Capital framework for ADIs" dated 14 February 2018, it is noted that different treatments than those recommended by the Basel Committee are being proposed for SME lending not secured by property. I.e. APRA is proposing a 85% risk weight instead of the Basel Committees recommended 75% risk weight. In addition, it is noted that different risk weights are being proposed that take into account LVR, if a loan meets APRA's operational requirements and/or if loan is owner occupied and principal and interest; or not. This appears to meet the Commission's requirements.

Warehouse lending

It should be noted that CommBank provides mortgage warehouses to a range of predominantly non-ADI mortgage lenders. As such, CommBank is unopposed to ***Draft Recommendation 7.1 (A proportionate approach to risks non-ADIs pose)***. CommBank notes the suggestion to review the scope of APRA's Prudential Standard APS 120 Securitisation (APS 120). CommBank believes that any such assessment should consider the risk-sensitivity of underlying assets and counterparties, and not lead to ADIs artificially being considered more risky than non-ADIs. CommBank notes that the recent changes to APS 120 not only impact the cost of warehouse provision, but also the cost of mortgage securitisation more broadly.

As a result, CommBank accepts ***Draft Finding 7.2 (New rules costly for non-ADIs)***.

Response to Information Requests

Information Request 16.1 Where can IRB accreditation processes be improved?

- IRB modelling would be assisted by allowing more flexible modelling and simpler reporting approaches. The challenge for many banks is historical data, and the expertise to support the risk modelling. In APRA's discussion paper "Revisions to the Capital framework for ADIs" dated 14 February 2018, it is noted that a different / simpler approach for small ADIs is being proposed. ADIs and Australian Banking Association (ABA) should work with APRA to determine the best approach available to achieve part or full IRB accreditation.

Information Request 7.1 How will prudential standard APS 120 affect you?

- APS 120 amended regulatory capital risk weights across all securitisation exposures: warehouses, term securitisations, hedging & support facilities. The regulatory capital allocation under APS 120 applies equally to standard and advanced ADIs for all securitisation exposures whether originated by ADIs or non- ADIs. Foreign banks, which are not bound by APS 120 are actively competing to provide securitisation financing in the Australian market. Global neutrality on securitisation risk weights would provide for more balanced competition between Australian and foreign warehouse providers.
- The impact of costs due to APS 120 changes for standard ADIs and non-ADIs varies and is difficult to quantify. Each warehouse provided by CommBank was assessed and the outcome was negotiated with each client having regard to client requirements, market conditions, funding costs, changes in general capital requirements and changes in APS 120. Different warehouses were priced and restructured in different ways reflecting these different factors. In some instances warehouse pricing reduced because clients provided or sourced additional credit support, however the cost of the additional credit support is unknown to CommBank so the overall impact is difficult to quantify. In some instances warehouse pricing increased but this was driven by the multiple factors outlined and it is difficult to quantify the change solely due to APS 120.
- CommBank was able to reach mutually agreeable outcomes for all warehouses and some non-ADI clients have requested increased warehouse limits.
- The Commission is also seeking estimates of the costs of obtaining similar levels of finance to that obtained through warehousing, such as through commercial loans in retail markets.
- Securitisation pools assets to obtain a rating / credit quality uplift from the underlying individual asset and originator. Pricing on any securitisation facility is dependent on the risk profile of the asset, transaction structure, risk profile of the securitisation tranche, volume, tenor and capability of transaction parties. Securitisation provides for cost effective funding across a range of assets and issuer types. In many cases, particularly for unrated, or lower rated entities, the volume, pricing and tenor of securitisation facilities could not be matched in un-securitised format via other funding channels.

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2.3 Balancing non-macro-prudential regulation

Key Points

- Before further regulatory intervention is considered, recent policy changes should be given time to work.
- CommBank 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.
- FinTechs and global technology companies are already successfully becoming part of everyday experiences in a range of customer relationships.

Summary of Response to Draft Recommendations

- CommBank supports in principle **Draft Recommendation** ***4.1 (Reducing regulatory barriers to entry and expansion)*** but before further regulatory intervention is considered, recent policy changes should be given time to work.
- CommBank supports in principle ***Draft Recommendation 10.2 (Making the ePayments code mandatory)***.
- CommBank supports in principle ***Draft Recommendation 10.1 (Review regulation of purchased payment facilities).***

Summary of Response to Draft Findings

- CommBank rejects ***Draft Finding 4.3 (Most FinTechs are focusing on less regulated services)***.
- CommBank rejects ***Draft Finding 4.4 (FinTech collaboration and competition)***.
- CommBank rejects ***Draft Finding 4.2 (Foreign banks remain predominantly niche operators).***

CommBank supports in principle the Commission's draft recommendations related to balancing non-macro-prudential regulation.

Reducing regulatory barriers to entry and expansion

CommBank takes this opportunity to reiterate Recommendation 3 of its Initial Submission 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.

In this context, as a leader in financial services innovation, CommBank 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. As noted in CommBank's Initial Submission, the Government has announced a package of changes including: relaxing the 15% ownership cap for new market entrants; removing the prohibition on the use of the word "bank" by entities with less than $50m in Common Equity Tier 1 (CET1) capital; and introducing a phased approach to the bank licensing process.

It should also be noted that increased 'RegTech' developments in the market, aimed at reducing the reporting burden through better approaches to data gathering, are ultimately lowering barriers for new entrants. CommBank supports these developments and has participated in ASIC's RegTech Liaison Forum meetings.

As such, CommBank supports in principle ***Draft Recommendation 4.1 (Reducing regulatory barriers to entry and expansion)*** but before further regulatory intervention is considered, recent policy changes should be given time to work. Specifically, if further regulatory intervention is being considered to achieve competition aims in the sector, then CommBank recommends that before deciding on the need for this, recent policy changes noted above should be given time to work.

ePayments code and purchased payment facilities

CommBank supports in principle ***Draft Recommendation 10.2 (Making the ePayments code mandatory)***. The ePayments code, while currently voluntary, is contractually enforceable for those institutions that subscribe to it. CommBank has been a subscriber for a long time. CommBank welcomes a level playing field; CommBank's customers need to have confidence in all the parties with whom they deal; as well as helping to preserve confidence in the broader payments system (including consumer protection, transaction security and financial crime implications).

CommBank also supports in principle ***Draft Recommendation 10.1 (Review regulation of purchased payment facilities)***. CommBank is supportive of a graduated licence framework for purchased payment facilities (PPFs) – and the review of PPF regulation. Any PPF providers that facilitate payments should provide the same level of protection for customers as other participants do. They should be required to meet KYC / AML, fraud, financial crime and risk management expectations to protect consumers and maintain integrity of, and confidence in, payment systems.

FinTechs and foreign banks

Regarding non-macro prudential barriers to entry and expansion for alternative players, CommBank has mentioned in its Initial Submission, that the Australian FinTech industry has seen record investment of $656m in 2016, up from $185m and $461m in 2015 and 2014 respectively[41]. CommBank believes that low competition hurdles in the financial system have encouraged new entrants. The number of Sydney-based FinTechs has grown from under 100 in 2014 to 579 in 2017, employing more than 10,000 staff[42]. In addition to FinTechs, a number of global technology organisations and other large organisations have entered the financial system 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.

As such, CommBank rejects ***Draft Finding 4.3 (Most FinTechs are focusing on less regulated services)***. Indeed, the context for this finding is that perceived barriers to entry are preventing FinTechs 'graduating' from niche players to genuine competitors. CommBank's view is that this is not a fair characterisation. FinTechs are focussed on niche segments and understand that there is a major step up to assume prudential obligations and broader duties of being a bank. FinTechs and global technology companies are already successfully becoming part of the everyday experiences in a range

41 KPMG, 2017, US$656m 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
42 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

of customer relationships. CommBank supports occasions where constructive intermediation drives positive customer outcomes.

Similarly, CommBank rejects ***Draft Finding 4.4 (FinTech collaboration and competition)***. CommBank notes that FinTechs are successfully providing alternatives to traditional banking products, for example AfterPay and Prospa. Many of those offerings are enabled through partnerships between FinTechs and large partners as demonstrated by the award for best FinTech / bank partnership received by CommBank and OnDeck in 2016. As per above, the challenge for FinTechs is to undertake the 'graduation' in organisational and system maturity to grow in scale.

With regard to foreign banks more specifically, CommBank rejects ***Draft Finding 4.2 (Foreign banks remain predominantly niche operators)*** on the basis that the finding is too generalised and doesn't recognise the difference in market segments and parts of the value chain where foreign banks are not niche operators. For example, foreign banks are not niche operators in online deposits, as highlighted by RBA in its initial submission to the Commission: "*The entry of new banks following the Wallis Inquiry resulted in an intensification of competition in deposit markets, notably through foreign banks competing for the provision of online deposits*". In addition, foreign banks are not niche operators in the business and institutional banking sectors, as highlighted by RBA in its initial submission to the Commission: *"There has recently been strong competition for large business lending as a consequence of the entry of new foreign banks and expansion in activity by some existing foreign banks"; "Over the past few years, the spread on large business lending has declined as competition has emerged from foreign banks".*

Response to Information Requests

Information Request 4.1 Should ASIC's regulatory sandbox be extended?

- In its last submission to this Inquiry CommBank noted that ASIC's regulatory sandbox has only been provided to FinTech competitors, in contrast to markets like Singapore where sandboxes are available to all financial market participants. CommBank believes that the regulatory sandbox should be accessible for all market participants, to encourage further innovation and collaboration between existing participants and new market entrants.
- CommBank also notes that last year Treasury consulted on an enhanced regulatory sandbox. CommBank contributed to, and supports, the ABA's submission to Treasury in this regard.

Information Request 10.1 How should liability for unauthorised transactions be shared?

- CommBank believes the general principle that the "negligent" party should carry liability.
- This is frequently an ambiguous area and consistency and improved clarity would be useful for market participants.
- A liability framework under the ePayments Code already exists but needs review to, among other things, consider Open Banking recommendations.
- It is premature to consider relying on an Open Banking policy in relation to access or unauthorised transactions. Not only is the detail of that policy / framework yet to be settled, not all unauthorised transactions are related to Open Banking inspired sharing. However, Open Banking needs to be considered in any ePayments Code review.

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2.4 Access to data and switching

Key Points

- CommBank is supportive of an Open Banking model that puts customers in control, and lifts competition and security in the industry.
- In the face of ever-increasing cyber threats, Australians need to understand the importance of keeping their data safe and private; Open Banking cannot diminish the protection and privacy customers enjoy today.
- CommBank is supportive of the customer-centric and security-first industry solution proposed by the ABA and more recently by Treasury, and CommBank is implementing the first phase this year.

Summary of Response to Draft Recommendations

- CommBank supports in principle ***Draft Recommendation 13.1 (Data access to enable switching)***.
- CommBank is unopposed to ***Draft Recommendation 10.5 (Access regime for the New Payments Platform)***. CommBank notes that the NPP has not yet fully launched.

Summary of Response to Draft Findings

- CommBank rejects ***Draft Finding III.1 (Consumers' capacity to put competitive pressure on providers is often limited)***.
- CommBank accepts ***Draft Finding 13.2 (Tick and Flick has not been effective)***.
- CommBank accepts ***Draft Finding 10.1 (The New Payments Platform could do more to ease customer switching).***

Switching

Evidence shows that Australians are taking advantage of a competitive market and are shopping around: three million people switched banks over the last three years and of those two-thirds (68%) found that switching was an easy process[43].

For transaction accounts, it is estimated that switching occurs at a rate of 8% to 10% per annum in the Australian market. This is a comparable rate compared to some European countries with more formal switching mechanisms[44].

With customer satisfaction across the Australian banking industry at historically high levels and the choice available to consumers around switching products such as home loans, credit cards and term deposits, it should be noted that there is less incentive for consumers to move their transaction account.

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43 Galaxy Research, February 2017
44 Treasury, "Banking: Cost effective switching arrangements", 2011, available online at: http://banking.treasury.gov.au/content/reports/switching/downloads/switchingarrangements_aug2011.pdf

CommBank fully supports competition and the ability for all Australians to choose a financial institution which best suits their needs. It has fully supported the industry's advancements in enhancing the customer switching experience, while spearheading a number of initiatives to support customers to switch banks easily.

CommBank hosts a wealth of information on its website to enable customers to switch easily. This includes instructions on what to do, a list of popular billers' contact details to save customers searching for them, template letters that can be downloaded to advise of direct debit changes and a "Notice of Variation of Account Details" authority form to automate the switch of recurring payments to the customer's new provider.

CommBank further enables consumer choice in switching to other financial institutions via same day closure for transaction and savings accounts, and immediate credit card closure (including via online channels with zero dollar balance and no pending transactions).

Future industry initiatives will continue to enhance the switching process, including:

- Open Banking (see further details below) framework currently being reviewed by Treasury, will empower consumers with increased control over their financial information and provide greater transparency regarding price and service offerings of different providers.
- NPP (see further details below) will introduce more flexibility regarding payment options. While it has not been designed for account switching it has potential to support the process as it will ultimately empower consumers to link different accounts to a number of unique personal PayIDs.
- ABA is incorporating a number of additional obligations into the new Code of Banking Practice to facilitate convenient switching. It is also collaborating with card Schemes to help banks facilitate requests to cancel recurring payment transactions on their cards.
- Implementation of Comprehensive Credit Reporting by July 2018 will further bolster choice by allowing lenders to offer competitive interest rates using a holistic servicing assessment which will facilitate borrowers switching between lenders.

For the above reasons, CommBank rejects ***Draft Finding III.1 (Consumers' capacity to put competitive pressure on providers is often limited)***.

Tick and Flick

CommBank accepts ***Draft Finding 13.2 (Tick and Flick has not been effective)***. It is worth noting that the current switching process is reasonably convenient and low friction. For example a customer can establish a cash transaction account with an alternative institution within minutes, and notify third parties of new account details within an hour.

CommBank is committed to continuing to review and improve the switching process so that it can support customers' financial choices. For example, CommBank introduced 'click to close' (where customers can cancel their card online) on credit cards in August 2017.

Open Banking

CommBank supports the 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. Importantly, CommBank is very supportive of an Open Banking model that puts customers in control, and lifts competition and security in the industry.

It should be noted that in the face of ever-increasing cyber threats, Australians need to understand the importance of keeping their data safe and private. Open Banking cannot diminish the protection and privacy customers enjoy today.

Furthermore, CommBank has considered Treasury's Final Report into the implementation of Open Banking. CommBank is very supportive of the customer-centric and security-first principles outlined in Treasury's Final Report. Specifically, elements of the model that CommBank supports are:

- Customers are empowered to access their data and send it to accredited companies.
- The framework is supported by risk-based accreditation to assure consumer confidence.
- Privacy and security remain key criteria in system design.
- The framework deals with liability reasonably, and participants are not required to cover each other's breaches.
- Government has the option to use this world-leading model across other industries such as telco, energy and health.

A particular element of the proposed system that CommBank supports is the principle of reciprocity. CommBank agrees with Treasury's recommendation that participants in the data sharing system that seek access to data should also be in a position to share an equivalent data set when instructed by consumers. This reciprocity is vital to enabling a data-driven economy and to maintain the healthy levels of innovation in banking but also other sectors.

CommBank's view is that implementation should commence with 'simple' banking products to test feasibility and also ensure there are no unforeseen adverse impacts.

It is also important that Australia learns from the UK operating model rather than duplicating elements of it that would not work for the Australian market and could potentially result in exposing Australian consumers. CommBank will be discussing these items constructively with Government and Industry.

As a result of the above, CommBank supports in principle ***Draft Recommendation 13.1 (Data access to enable switching)***.

New Payments Platform

CommBank is unopposed to ***Draft Recommendation 10.5 (Access regime for the New Payments Platform)***. However, it should be noted that the NPP has not yet fully launched. It is likely to be detrimental if regulation was implemented at this stage, before it is understood through actual experience, whether there is a need for regulatory intervention, and what the consequences (intended and unintended) are likely to be.

NPP Australia (NPPA) is already working with a wide range of potential new entrants in the overlay services space, and with players who could directly connect to the infrastructure. The Draft Report correctly sets out a range of graduated access levels including Participant (of which there are a few variants), Connected Institution, and Overlay Service Provider (OSP). The access criteria for each are clear and transparent, and available to any potential applicant in the NPP Regulations and also in material on CommBank's website.

In relation to fees, this information is available either on NPPA's website in the case of Overlay Service Providers (OSPs), or under NDA. Importantly, the presumption enshrined in the regulations is in favour of admission where the eligibility criteria are satisfied. NPPA is confident that the governance arrangements in place – including RBA representation on the board, and two independent directors (one of whom is the chair), will enable it to manage any conflict of interests which might arise. The Draft Report notes, and NPPA recognises, the powers of the RBA to designate the system and impose an access regime in the event of market failure. CommBank believes an assessment of the adequacy of NPP access is premature and if considered in the future, should adhere to the principle of a fair and commercial return for the NPP's investors.

It is also worth mentioning that the NPP will introduce more flexibility regarding payment options - while it has not been designed for account switching it has potential to support the process as it will ultimately empower consumers to link different accounts to a number of unique personal PayIDs.

Consequently, over time, as the NPP scales and matures, CommBank accepts ***Draft Finding 10.1 (The New Payments Platform could do more to ease customer switching)***.

Response to Information Requests

Information Request 13.1 To what extent does holding multiple accounts reduce or enable switching?

- Approximately 5% of CommBank's core everyday transaction accounts are in a dormant state, i.e. no activity on the account in the prior 6 months.
- It can be assumed that a large share of dormant accounts is correlated to customers switching providers or products.
- In relation to the distribution of product holdings across the Australian population, CommBank's distribution of product holdings across its consumer customers is shown in Table 1.

Table 1: Average number of products held by retail customers - CommBank[45]

CBA Group *average number of products per customer*	**August 2017 - January 2018**
Total	**3.09**
Savings and Transaction account	1.46
Term Deposits	0.05
Total Accounts	**1.51**
Work Super	0.10
Personal Super	0.01
Total Super	**0.11**
Managed funds incl. CMT	**0.02**
Major cards	0.88
Total Cards	**0.88**
Home loan	0.19
Personal Lending	0.05
Total Loans	**0.24**
Total Insurance	**0.33**

45 Roy Morgan Research, average number of products per customer. CommBank "Any Financial Relationship" Customers 18+, Banking and Finance products per Banking and Finance customer at CommBank. 6 month rolling average to January 2018. CommBank excludes Bankwest

Response to Information Requests

Information Request 13.3 What red tape barriers to switching persist?

- CommBank supports competition and the ability for all Australians to choose a financial institution which best suits their needs. It has fully supported the industry's advancements in enhancing the customer switching experience, while spearheading a number of initiatives to support customers to switch banks easily.
- However, given the perception that switching banks is not easy, clearly more can be done at an industry level to educate consumers about the process; and CommBank is committed to continuing to invest to enable switching to be more convenient.
- With customer satisfaction across the Australian banking industry at historically high levels and the choice available to consumers around switching products such as home loans, credit cards and term deposits, it should be noted that there is less incentive for consumers to move their transaction account.
- Whilst it is often perceived that the hurdle to switching is identifying and porting direct debit and recurring payments, it is estimated switching of transaction accounts occurs at a rate of 8% to 10% per annum. When compared to advanced European countries with more formal switching mechanisms in place, this is a comparable rate.
- Future industry initiatives will continue to enhance the switching process, including:
    - Open Banking framework currently being reviewed by Treasury, will empower consumers with increased control over their financial information and provide greater transparency regarding the service offerings of different providers.
    - NPP will introduce more flexibility regarding payment options. While it has not been designed for account switching it has potential to support the process as it empowers consumers to link a different account to their PayID.
    - ABA is incorporating a number of additional obligations into the new Code of Banking Practice to facilitate convenient switching. It is also collaborating with card Schemes to help banks facilitate requests to cancel recurring payment transactions on their cards.
    - Implementation of Comprehensive Credit Reporting slated for July 2018 will further bolster choice by allowing lenders to offer competitive interest rates using a holistic servicing assessment which will facilitate borrowers switching between lenders.

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Chapter 3. Examining industry practices for better customer outcomes

3.1 An effective and efficient payments system

Key Points

- There should be no further changes in interchange regulations until the effects of changes recently introduced as a result of the RBA's grassroots review of interchange are evaluated.
- Australia has one of the most innovative and secure payments systems in the world, as well as one of the lowest interchange fee regimes globally.
- The payments system is a complex, high fixed cost system with multiple participants. Interchange is a proven model globally for balancing the costs and benefits for various participants.
- Interchange fees cover a number of system-wide costs and direct consumer benefits (in particular fraud protection) and enable investment in innovation and efficiency in the payment system.
- Banning interchange fees could undermine the economics of the system, and lead to a reduction in system security and resilience, as well as reduce innovation and other direct consumer benefits.
- CommBank is committed to providing customers with choice and flexibility when it comes to how they want to pay.
- CommBank is currently assessing the implementation of additional capabilities to enable merchant routing for contactless debit transactions and supports the industry working together to ensure a high standard of customer experience and choice is maintained for both merchants and cardholders.
- Cardholders should have the ability and right to over-ride any merchant routing decisions.

Summary of Response to Draft Recommendations

- CommBank does not support ***Draft Recommendation 10.3 (Ban card interchange fees)***.
- CommBank supports in principle ***Draft Recommendation 10.4 (Merchant choice of default network routing).***

Payments are the lifeblood of an economy. The payments system provides individuals, businesses and institutions choice in how they transfer value, from individuals paying for purchases using 'tap and go' to institutions transferring large sums. It is critical to the economy and the everyday lives of Australians that the payments system is reliable, safe and drives innovation for convenience and efficiency.

Interchange fees

There have been successive reforms concerning interchange over the last 15 years and many have had unforeseen consequences. Interchange fees were reduced as recently as July 2017. CommBank believes there should be no further changes in these regulations until the RBA has had the opportunity to evaluate the effects of the changes introduced in July 2017 following its grassroots review of interchange.

Australia has one of the most innovative and secure payments systems in the world, as well as one of the lowest interchange fee regimes in the world. For example, Australia leads the world in contactless payment usage[46] and introduced PIN-only authorisation for credit card transactions in 2014. There is some evidence that accepting cash can be more expensive to merchants than card payments. Australia's weighted average interchange on credit of 0.50% and cap of 0.80% is substantially lower than other markets such as the USA which can be up to 3.25% + 10 cents (refer Table 2). Debit interchange fees are regulated by the RBA and are low by international standards.

The higher rates of interchange in the USA enable higher investment in fraud protection and innovation in payments systems, benefiting consumers and businesses.

Table 2: Interchange rates in comparable overseas markets[47]

Country / Region	Regulation	Credit rates	Debit rates
	Yes	Weighted average 0.50%, cap of 0.80%	AUD$0.08, cap of $0.15 or 0.20%
	Debit only	From 0.00% + USD0.65 To 3.25% + USD0.10	0.05% + USD0.21
 	Yes	0.30%	0.20%
	Voluntary	From 1.00% to 2.06% Contactless (<CAD25) CAD0.05 - CAD0.07	From 0.00% + CAD0.02 to 1.00%
	No	From 0.00% charities only To 2.35% premium only	From 0.00% charities only To 1.50% commercial Contactless NZD0.004 – NZD0.10

46 RFi Group, Global Payments Evaluation Study, 2015.
47 Mastercard, available online at Mastercard individual country websites.

Surcharging of card payments is regulated through the RBA and enforced through the ACCC.

The payments system is a complex, high fixed cost system with multiple participants who each benefit in different ways. Interchange is a proven model globally for balancing the costs and benefits of various participants.

Interchange fees cover a number of system-wide costs and direct consumer benefits including:

- Card issuing costs (including replacements, damaged, emergency cards).
- Fraud losses (which in an EMV (PIN) environment are absorbed by issuers).
- Customer protection (dispute and chargeback rights).
- System costs (such as transaction processing, fraud monitoring, card personalisation, AML/CTF/Sanction screening).
- Compliance costs.
- Enables global access to customer's accounts through electronic means (both ecommerce and POS).
- Innovation (for example contactless cards, mobile payments, lock, block & limit).
- Customer reward and loyalty benefits.
- Other consumer benefits such as insurance.

The direct impact to consumers of a proposed ban on interchange fees could undermine the economics of the system, and lead to a reduction in system security and resilience, as well as reduce innovation and other direct consumer benefits.

Consequently, CommBank does not support ***Draft Recommendation 10.3 (Ban card interchange fees)***.

Routing of merchant transactions

CommBank is committed to providing customers with choice and flexibility when it comes to how they want to pay. For example, despite merchant terminals defaulting 'Tap & Pay' debit card transactions to Visa rails, consumers have the choice of selecting EFTPOS if they wish.

Competition within the domestic acceptance market is vigorous with all major banks, local and international acceptance providers participating and competing for market share. Domestic interchange fees are published and easily accessible by merchants for both Visa and Mastercard.

When setting up their acquiring facilities with their acceptance partner, a merchant will select the pricing arrangements that best suits their business needs.

Many acceptance providers in the market offer variations of an 'interchange plus' pricing structure where the underlying interchange of a card transaction is passed directly through to the merchant. This pricing structure is therefore completely transparent to the merchant with respect to interchange costs. In the typical 'interchange plus' merchant acquiring arrangement, the interchange fee at point of sale will depend upon 1) which Scheme card the customer selects to use, 2) value of transaction, 3) what type of merchant it is and if it qualifies for Strategic Merchant Rates[48], 4) if the customer choses

48 Strategic Merchant Rates are rates available to typically large volume merchants (or merchant groups) that meet certain qualifying criteria deemed to be strategic to the Scheme.

to use commercial, premium or standard card which may have different benefits, and 5) whether it is a domestic issued or overseas issued card. Thus the uncontrollable aspect of interchange for a merchant is the type of card presented by the consumer, which may have an adverse cost impact to the merchant depending on the card.

This was a key finding of the FSI and was subsequently addressed by Reserve Banking regulation which came into effect 1 July 2017 where interchange was capped domestically at 0.80% for domestic credit cards and 0.20% or 15 cents for domestic debit cards.

The complexity of customer choice can make it challenging for merchants to know the exact cost of accepting the specific card payment. Increasingly smaller merchants can avoid such uncertainty through fixed fee arrangements (whereby card variability risk is taken on by the acquiring bank).

EFTPOS only recently began supporting contactless transactions, whereas the Schemes have supported them for over a decade. Hence, routing debit transactions to the lowest cost path has only recently become an option.

CommBank supports in principle ***Draft Recommendation 10.4 (Merchant choice of default network routing)***.

The industry needs to ensure the benefits and services cardholders receive through different Schemes are not compromised should merchants choose to route transactions through a particular payment network. Cardholders should therefore also have the ability and right to over-ride any merchant routing decisions.

CommBank is currently assessing the implementation of additional capabilities to enable merchant routing for contactless debit transactions and supports the industry working together to ensure a high standard of customer experience and choice is maintained for both merchants and cardholders.

Response to Information Requests

- No information requests are made in relation to this topic.

3.2 Improving customer choice and outcomes in residential home lending

Key Points

- Mortgage brokers play an important role in the industry and help customers with one of the most important financial decisions they make in their lives.
- CommBank uses brokers and a proprietary lending network as each provides a distinct value proposition to large proportions of customers.
- The share of retail home loans that CommBank receives from its owned aggregator (Aussie Home Loans) is typically lower than the share that CommBank receives from other independent brokers.
- Contrary to the finding of the Commission, ASIC has found that broker customers pay interest rates that are no better, and in some cases worse, than those customers who are served by proprietary channels.
- CommBank has been a major contributor to industry efforts to improve customer outcomes in mortgage broking, including through changes to its own broker accreditation programme focused on ensuring brokers deliver positive customer outcomes.
- The ASIC and ABA Retail Banking Remuneration (Sedgwick) reviews on broker remuneration have proposed that a range of other remuneration arrangements be considered, some of which propose moving away from trailing commissions. CommBank supported these reviews and is open to further discussing ways to address the concerns identified in these reviews.
- Home loan pricing is influenced by various factors such as loan terms and customer characteristics such as risk. Hence customer level pricing is personalised and also accounts for the prevailing conditions at the time of application.
- Customers already have access to personalised price transparency through lenders, brokers and online tools.
- The Commission's proposed price reporting tool may harm price competition and innovation, mislead customers and may result in reluctance by market participants to offer loans to customer with risk higher than the median.
- Lenders Mortgage Insurance (LMI) currently allows customers with low or no deposit to secure credit, allowing them to purchase a home sooner.
- CommBank passes through the cost of the LMI premium to consumers from its insurance providers. CommBank does not charge a margin or fees above this premium.
- LMI does not fully compensate for the additional risk associated with providing loans to higher LVR customers, hence the residual additional risk is compensated for through higher interest rates.
- Implementing LMI refunds could result in a more costly product. Borrowers should be able to choose between the current 'non-refundable' premium product and the more flexible alternative suggested by the Commission.

Summary of Response to Draft Recommendations

- CommBank does not support *Draft Recommendation 8.1 (Duty of care obligations for lender-owned aggregators)*, unless it is applied to all brokers at the same time.
- CommBank supports in principle *Draft Recommendation 8.2 (Mortgage broker disclosure requirements).*
- CommBank is unopposed to *Draft Recommendation 8.3 (Collection of home loan interest data)* but questions the value of the activity.
- CommBank does not support *Draft Recommendation 8.4 (Interest rate transparency for home loans)*.
- CommBank is unopposed to *Draft Recommendation 8.5 (Lenders mortgage insurance refund)*.

Summary of Response to Draft Findings

- CommBank notes *Draft Finding 8.2 (Cost of home loans through brokers vs branches).*
- CommBank rejects *Draft Finding 8.1 (Interest rates from brokers vs other channels).*
- CommBank rejects *Draft Finding 13.1 (Mortgage broker commission structures weaken consumer switching).*
- CommBank rejects *Draft Finding 8.3 (If you have a high loan to value ratio, you are probably paying for it twice over).*

3.2.1 Mortgage brokers play an important part in providing customer choice

Mortgage brokers play an important role in the industry and help customers with what is one of the most important decisions they will make in their financial lives. Brokers offer a valuable service proposition, including offering a range of products from different providers.

CommBank's involvement in the broking industry

CommBank uses brokers and a proprietary lending network as each provides a distinct value proposition to large proportions of customers.

Each of these channels has costs which are specific to that channel. CommBank does not allocate branch costs to individual interaction or transaction categories, such as writing a home loan. CommBank notes *Draft Finding 8.2 (Cost of home loans through brokers vs branches)*.

CommBank is proud to own leading mortgage aggregator Aussie Home Loans (AHL).

Consistent with the broking value proposition of independence, CommBank loans are provided as a part of a panel of loans, with the broker determining the most suitable loan for each customer. Most loans originated through AHL go to CommBank's competitors.

The share of retail home loans that CommBank receives from AHL is in fact typically lower than the share that CommBank receives from other independent brokers. For example from the latest available data (September 2017) CommBank received an average share of 16.9% of approvals via the top ten broker headgroups, versus 16.1% of approvals via AHL.

AHL also sells its own branded products which are wholesale funded by Macquarie Bank and CommBank. Several other banks also provide wholesale funding arrangements for other brokers irrespective of whether the broker is owned by those banks.

Customer outcomes in broker channels

Contrary to the finding of the Commission, ASIC has found that broker customers pay interest rates that are no better, and in some cases worse, than those customers who are served by proprietary channels. ASIC's findings suggested higher interest rates, larger loan sizes, more interest only loans, and higher leverage. Although these outcomes may be appropriate for many customers, their net effect is that overall broker customers may take longer to repay loans, and incur more interest, than those served by proprietary lenders. Hence, CommBank rejects ***Draft Finding 8.1 (Interest rates from brokers vs other channels)***.

CommBank believes the vast majority of brokers do the right thing and want to help their customers. CommBank has been a major contributor to industry efforts to improve customer outcomes in mortgage broking, including through changes to its own broker accreditation programme focused on ensuring brokers deliver positive customer outcomes.

Commissions

As in other financial services products, a combination of upfront and trailing commissions has been used to balance the upfront and ongoing costs of establishing and maintaining a customer relationship. Upfront commissions are paid to compensate brokers for the work associated with the home loan application and to reflect the value to the bank of a new home loan customer. Trail commission payments are made to compensate brokers for the ongoing costs associated with servicing and maintaining home loans.

Brokers are able to freely move customers between financial institutions, should this be in the best interests of customers. Should brokers switch a customer between institutions they are typically paid a 'new' upfront commission (which can offset any commission clawback if the switch has occurred within 2 years of initial funding).

The ASIC and ABA (Sedgwick) reviews on broker remuneration have proposed that a range of other remuneration arrangements be considered, some of which propose moving away from trailing commissions. CommBank supported these reviews and is open to further discussing ways to address the concerns identified in these reviews.

CommBank rejects ***Draft Finding 13.1 (Mortgage broker commission structures weaken consumer switching)*****.**

Improving customer outcomes and choice

CommBank supports actions that help customers better understand the service that brokers provide, and the ownership and remuneration arrangements that may influence how that service is performed.

CommBank recognises the potential customer benefits of the Commission's proposal to implement new duty of care obligations for brokers, however CommBank does not support ***Draft Recommendation 8.1 (Duty of care obligations for lender-owned aggregators)***, unless it is applied to all brokers at the same time to avoid confusion for consumers and maintain an even playing field for industry participants.

It would be important to ensure that any duty of care obligations allow for brokers to consider price together with the full range of product features that may be of value to customers, for example physical branch networks, access to digital banking, product flexibility (redraw, offset, etc.).

CommBank notes the Commission's view that "there is a strong in-principle case for a similar duty of care to be applied to all brokers." CommBank considers that, should the Commission choose to proceed with these recommendations, additional obligations should be applied universally to all brokers at the same time. Different regimes for brokers based on ownership would cause significant and unnecessary confusion for consumers in selecting a broker and what they can expect from the service.

Given brokers are able to move freely between lenders (and other aggregators), partial implementation would risk allowing some brokers to easily avoid additional obligations.

Delaying universal implementation has no practical value when the eventual disclosure and duty of care obligations are to be universal and it leaves unaddressed conflicts of interest that might arise through the sale of white-labelled products by brokers. CommBank agrees with the Commission that, as demonstrated by direct evidence from brokers, white-labelled products represent apparent conflicts of interests today and hence may warrant attention.

CommBank supports greater disclosure requirements, if they are universal. Customers should have all the information that helps them make the right decision for them, and this includes understanding what might – in some cases – influence recommendations. This information should be presented in a way that is not confusing, and at the right time (as early in the broker interaction as possible). Consequently CommBank supports in principle ***Draft Recommendation 8.2 (Mortgage broker disclosure requirements)***.

Response to Information Requests

Information Request 8.1 How should new duty of care obligations for lender-owned aggregators be implemented?

- CommBank believes a number of new duty of care arrangements are potentially workable, if they are applied to all brokers. However it would be important to ensure that any duty of care obligations allow for brokers to consider price together with the full range of product features that may be of value to customers, for example physical branch networks, access to digital banking, product flexibility (redraw, offset, etc.).
- CommBank is available to work with the appropriate bodies to develop detailed requirements.

Information Request 8.2 Should consumers pay broker fees for service?

- CommBank is open to dialogue regarding the structure of broker commissions.
  - CommBank believes that brokers could continue to offer their services to customers if consumers were to pay for their services directly.
  - However, CommBank notes that the ASIC review on broker remuneration and the ABA (Sedgwick) Review both identified other changes as more important mechanisms to improve customer outcomes in the broker channel. For example, the ABA review recommended moving to alternative commission structures that are not directly linked to loan size.
  - Based on these inquiries, CommBank's view is that changes to the level and structure of commissions (and other forms of fees) may be as or more important in influencing customer outcomes than whether these fees are paid directly or indirectly by consumers.
- CommBank also notes that experience in the financial advice sector suggests changes of this kind require universal application to ensure they deliver the maximum benefit to customer outcomes.

Information Request 13.2 Is there a rationale for the structure of mortgage broker commissions?

- As in other financial services products, a combination of upfront and trailing commissions has been used to balance the upfront and ongoing costs of establishing and maintaining a customer relationship.
- Upfront commissions are paid to compensate brokers for the work associated with the home loan application and to reflect the value to the bank of a new home loan customer. Trail commission payments are made to compensate brokers for the ongoing costs associated with servicing and maintaining home loans.
- The ASIC and ABA (Sedgwick) reviews on broker remuneration have proposed that a range of other remuneration arrangements are considered, some of which propose moving away from trailing commissions.
- CommBank supported these reviews and would be happy to further discuss ways to address the concerns identified in these reviews.

3.2.2 Transparency in home loan interest rates

The interest rate consumers pay for home loans have significant implications for the overall cost of a loan, and hence consumers' financial wellbeing. Increased sophistication in the collection and analysis of data on financial markets, property securities and customer characteristics has moved home lending pricing away from 'one size fits all' to a more sophisticated assessment of factors such as risk.

Like many other banks, CommBank has made significant investments to improve the way in which it prices its home loans and in the home buying experience for customers. The intent of this investment has been to reach the best possible balance between prudential requirements, responsible lending, and commercial value. Customer research proves that home loan prices are a major driver of customer choice and satisfaction, so improvements in this area are important to the home lending business.

The result of this investment is that home loan pricing now reflects more a more granular assessment of risk including security value and characteristics; availability of a deposit; prior credit behaviour; ability to service the loan; and loan characteristics including loan-to-value ratio (LVR). Therefore, home lending prices reflect the relative risk and return of the proposed loan compared with a standardised benchmark.

Transparency already exists in the market

Price comparisons that reflect this sophistication are already readily available to customers, and these comparisons are becoming easier to obtain.

As the Commission's data shows, most customers already know (or quickly learn) that banks' standard variable rates are indicative benchmarks, not prices typically paid by customers.

Actual offer prices, suitable for accurate like-for-like comparisons can be quickly obtained by consumers today. In CommBank's proprietary channel, automated pricing tools can quickly provide close-to-final customised prices. Either with a broker's assistance or independently, customers can obtain additional actual offers from other institutions with similar speed. Comparison websites and emerging digital brokers offer automated comparison services based on some (although not all) relevant borrower characteristics.

Ease of obtaining actual offers is also increasing. Many institutions are aware that the ability to quickly offer a price that is close to final is important to customers' choice of lender, and are investing to improve this capability.

CommBank prices new and historical loans in similar ways, however the price offered reflects the characteristics of the borrower, the loan and the underlying market conditions at the time the loan was funded. Loans are assessed based on the characteristics of the applicants and the loan, while the pricing available also reflects underlying funding costs and market conditions. Differences between newer and older customers can occur because this assessment happens at different times. The underlying cost components of providing home loans move over time, as does the profile of written business, impacting the rates that can be offered, for example:

- The costs of funding loans depends on prevailing market conditions at the time a loan is written.
- The bank must secure long-term funding for a loan at the time it is written, having secured this funding the costs are 'fixed' even if market conditions change. Hence a 'historical' loan may have very different costs associated with it, when compared to a new loan (for example loans written during the GFC (which had high funding costs) versus now).

- Property values have generally risen, contributing to an increase in average loan sizes which are subject to higher discount tiers.
- Changes in risk appetite have reduced the share of total lending that is in the higher LVR brackets (>80%), higher LVR loans typically receive lower discounts.

Proposed changes to improve informed choice by consumers

CommBank is very supportive of initiatives that make it easier for customers to get the information required to help them make better financial decisions. CommBank supports efforts to ensure that customers are fully informed about the interest rate associated with their home loans, as well as other fees and charges, and other 'non-price' components of a home loan offer.

Proposals to provide more information on historical interest rates need to be carefully evaluated to make sure they don't mislead customers and lead to unintended lender behaviour. It is CommBank's view that the Commission's online median price proposal is more likely to create poor competitive outcomes than appeal to customers, even before taking into account the additional effort and complexity to be managed by financial institutions and consumers alike.

Consumer appeal may be limited due to the required complexity of using and interpreting outcomes:

- The Commission's data shows large variations of actual prices from medians within simple customer segments. Consequently, many customer characteristics will be needed to obtain prices that can be relied upon for comparison, complicating use and interpretation of the tool.
- To be useful and representative, information needs be collected and presented in a granular format with inputs such as LVR, loan size, loan type, repayment type and product. For more advanced institutions rates are also influenced by detailed modelling of customer risk, behaviour, and cost of funding. This will be onerous for customers to complete akin to a full application and if not collected at a granular level will have a very broad rate range which will not be beneficial to customers.
- Because loan risk assessments typically rely on personal information – including salaries and other loans – meaningful results will require the submission of this usually confidential information to ASIC.
- The proposed tool is already duplicated and – as actual not theoretical offers are obtained – surpassed by traditional mortgage brokers, and increasingly by digital brokers, at similar levels of convenience.
- Because ASIC's tool can only ever deliver indicative prices, efforts to use this tool will inevitably be duplicative to the process of obtaining actual offers.

By contrast the tool will be a new and valuable source of intelligence on competitor pricing strategies, with the potential outcome of greater price alignment:

- For the tool to be useful, it will need to publicly provide granular information on pricing approaches, revealing pricing models which constitute commercially sensitive intellectual property.
- This represents a consequential risk of allowing prices to become more aligned across the industry.
- This could happen, for example, by dulling incentives for emerging players with less sophisticated pricing models to invest in these models. Instead these players would simply be able to closely match rates of major players. For example, an emerging player targeting higher

risk customers would no longer need to develop a new pricing technique but instead simply price to the median price revealed by the tool.

Further, to the extent that the tool is relied on by borrowers, lenders may become reluctant to offer loans to borrowers whose risk profile is higher than the median in any particular category.

Alternatively, price information provided at a high level runs the risk of misleading customers who have different risk or security characteristics to the median, and therefore mean that they cannot receive the price quoted.

It is important to note that this information already exists in the market for fixed and basic products. The rates advertised by banks and numerous comparison websites are closely aligned to end rates that customers receive.

As a result of these considerations, CommBank does not support ***Draft Recommendation 8.4 (Interest rate transparency for home loans)***. Consequently, whilst unopposed to ***Draft Recommendation 8.3 (Collection of home loan interest data)***, CommBank questions the value of the collection activity.

If this initiative proceeds, it will be important to ensure that it does not contravene laws regarding collusive or anti-competitive conduct. For example, the ACCC has previously taken action against providers of information on fuel industry pricing on the basis that these arrangements can facilitate collusive conduct. Given the time taken to negotiate loans, and the frequency of material funding cost changes, even recent retrospective data risks raising similar concerns in home lending.

3.2.3 Improving customer outcomes in Lenders Mortgage Insurance

LMI is a product designed to improve access to the home lending market for a higher risk segment of customers (i.e. those with less than a 20% deposit). LMI currently allows customers with low or no deposit to secure credit, allowing these customers to purchase a home sooner. Failure to offer LMI would require an increase in interest rates or (alternatively) make extension of credit difficult or (in some cases) impossible.

LMI premiums are a specific charge to compensate for a single risk – that of outright default. LMI is currently made available to a portfolio of similar customers through pooling of risk by insurers. This approach means premiums account for expected average loan characteristics.

CommBank passes through the cost of this premium to customers from its insurance providers. CommBank does not charge a margin or fees above this premium. The current products provided by CommBank’s insurers are not priced on loan term, but rather on the risk associated with accepting loans that fit within certain loan parameters (LVR, loan type, etc.). CommBank takes consideration to ensure that the LMI rate and the offering that goes with it, along with the mortgage product, are competitive in the marketplace.

Under the terms of CommBank's LMI products, its insurers do not provide refunds for customers who refinance or payout their loan. Where CommBank's insurers provide refunds for some customers on compassionate grounds, for example when an adverse change in personal circumstances requires an unplanned property sale, CommBank provides these refunds to customers. CommBank rejects the Commission’s inference that its insurers provide refunds to customers which CommBank does not subsequently make available.

It is important to note that LMI protects the bank against losses associated with a customer who has defaulted on their loan. LMI does not however fully compensate the bank for the costs associated with providing loans to higher LVR customers (for example higher capital costs, collection costs associated with customers who go into arrears by subsequently recommence repayments).

CommBank rejects ***Draft Finding 8.3 (If you have a high loan to value ratio, you are probably paying for it twice over)***, particularly the assertion that CommBank seeks to recover in the interest rate risks protected against through LMI. LMI does not fully compensate for the additional risk associated with providing loans to higher LVR customers, hence the residual additional risk is compensated for through higher interest rates. Notwithstanding the above, as the Commission has noted in its draft report, "the difference is small, at 0.00066% of the average interest rate for all borrowers".

With respect to ***Draft Recommendation 8.5 (Lenders mortgage insurance refund)***, CommBank notes that this recommendation implies replacement of the current LMI product design with a potentially more expensive option which could restrict access to home financing for some customers – a new type of LMI. Prices would need to reflect the cost of providing additional flexibility, resulting in higher up front premiums. Customers who repay their loan over longer time periods - even across multiple banks - may pay more relative to the current product. To the extent these additional costs impact loan serviceability, this would compromise access to credit for some customers.

CommBank is unopposed to ***Draft Recommendation 8.5 (Lenders mortgage insurance refund)***. If the recommendation were implemented, CommBank would welcome a discussion about what specific product design would be most compatible with the Commission's objectives, while limiting adverse impacts on the availability of credit or on costs to customers. In particular, CommBank proposes that borrowers be able to choose between the current 'non-refundable' premium product and the more flexible alternative suggested by the Commission.

One alternative model put forward has been to factor the cost of LMI directly into the interest rate charged. This would be detrimental to customers as total premiums paid by customers would increase. For example, it would drive significantly higher transaction, processing, monitoring and control costs due to the complexity of calculating, deducting, passing on and reconciling individual monthly payments. Charging LMI through higher interest as part of the repayment will also mean that customers who go into arrears, default or claim will stop payment premiums before the full cost is recovered. Again this would result in higher monthly premiums which are disproportionately borne by those who continue to service their loans.

Response to Information Requests

Information Request 8.3 Are Changes Needed To Lenders Mortgage Insurance?

- CommBank rejects ***Draft Finding 8.3***, particularly the assertion that CommBank seeks to recover in interest rate risks protected against through LMI, hence does not consider *Information Request 8.3* requires a response.

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3.3 Improving customer choice and outcomes in insurance

Key Points

- The insurance market has witnessed new entrants to Australia in recent years, with the rise of challenger brands, innovation in products and new solutions for customers.
- CommBank supports making it simpler and easier for customers to make informed choices in relation to their insurance arrangements.
- CommBank does not offer add-on style insurance sold through car yards.
- Following a review of consumer credit insurance products, CommBank recently announced the decision to end sales of its Credit Card Plus and Personal Loan Protection products as it found it was difficult to achieve the right balance between simplicity and accessibility on the one hand, and limiting the product to the right group of target customers on the other hand.
- CommBank believes it is important that customers consider risks that can occur at various points in life, therefore it is appropriate to invite customers to consider if they want to reduce their risk via insurance, when they are taking on more responsibilities, for example purchasing a home.

Summary of Response to Draft Recommendations

- CommBank is unopposed to ***Draft Recommendation 11.1. (Past pricing information on insurance renewal notices)*** however recommends that the implementation be carefully considered to minimise confusion for consumers.
- CommBank supports in principle ***Draft Recommendation 11.2 (Transparency on underwriting)***.
- CommBank supports in principle ***Draft Recommendation 14.1 (Deferred sales model for add-on insurance)***.
- CommBank supports in principle ***Draft Recommendation 11.3 (Phase out stamp duties levied by the states and some of the territories)***.

Summary of Response to Draft Findings

- CommBank accepts ***Draft Finding 11.2 (Consolidation of General Insurers)***.
- CommBank accepts ***Draft Finding 11.1 (Market power in general insurance provision).***

General Insurance

In the process of securing and enhancing the financial wellbeing of its customers, CommBank believes it is important to be able to help those customers protect their home, their possessions, and their motor vehicles. CommBank's general insurance business (under the CommInsure brand) helps protect the financial wellbeing of more than 1 million policyholders.

The insurance market has witnessed new entrants to Australia in recent years, with the rise of challenger brands, innovation in products and new solutions for customers.

Representations to the Senate Economics Committee Inquiry into General Insurance noted that 'Australia's general insurance industry is highly competitive, contending that the large number of participants in the market and recent entry of challenger brands are evidence of this fact'.

APRA data shows there was 96 insurers licensed to conduct general insurance business as at 30 September 2017, of which 86 were direct insurers and 10 reinsurers. APRA also noted that "The personal lines market continues to display healthy competition. Incumbents have maintained a competitive position in all classes of business, while coming under increasing pressure from challenger brands (such as Auto and General, Youi and Hollard), which continue to grow their market share".

As the Commission has noted, the sector is however relatively concentrated amongst a number of large insurers.

CommBank accepts ***Draft Finding 11.1 (Market power in general insurance provision)*** and accepts ***Draft Finding 11.2 (Consolidation of General Insurers)***.

CommBank supports making it simpler and easier for customers to make informed choices in relation to their insurance arrangements.

CommBank supports in principle ***Draft Recommendation 11.2 (Transparency on underwriting)***. CommBank is also unopposed *to* ***Draft Recommendation 11.1. (Past pricing information on insurance renewal notices)*** however CommBank recommends that the implementation be carefully considered to minimise confusion for consumers.

Add-on insurance

CommBank does not offer add-on style insurance sold through "car yards". Following a review of consumer credit insurance products, CommBank recently announced the decision to end sales of its current Credit Card Plus and Personal Loan Protection products as it found it was difficult to achieve the right balance between simplicity and accessibility on the one hand, and limiting the product to the right group of target customers on the other hand.

CommBank is working with AIA, a leading global insurer which is acquiring the CommInsure life insurance business from CommBank, to deliver new and innovative protection solutions for its customers, so that an important need can be met. These new solutions will build upon the recent improvements to product design and sales processes that have been developed by ASIC and the industry to improve customer outcomes.

CommBank believes it is important that customers consider risks that can occur at various points in life, therefore it is appropriate to invite customers to consider if they want to reduce their risk via insurance, when they're taking on more responsibilities for example when buying a new home.

Recognising some of the issues identified in the add-on insurance sold through "car yards", CommBank supports in principle ***Draft Recommendation 14.1 (Deferred sales model for add-on insurance***). CommBank supports a deferred sales model for consumer credit insurance in face to face and phone based sales channels as is being introduced through the updated Banking Code of Practice. This reform should be given time to commence to allow further assessment of how this model impacts on consumers.

Stamp Duty

As the Commission has noted, stamp duties on insurance are particularly inefficient taxes because of their narrow base, the distortions to insurance prices, and reduction in insurance affordability. They create an incentive to not insure. Consequently, CommBank supports in principle ***Draft Recommendation 11.3 (Phase out stamp duties levied by the states and some of the territories)***. CommBank encourages government to work with the states and territories that levy stamp duties on insurance to promptly progress this recommendation.

Response to Information Requests

- No information requests are made in relation to this topic.

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3.4 Improving customer choice and outcomes in financial advice

Key Points

- CommBank supports the proposal to rename General Advice and the intent to increase access to advice and the safe delivery of information or guidance to customers. In relation to the proposal to rename General Advice, CommBank encourages any proposed changes to be considered in a broad context so that potential unintended consequences are fully understood and mitigated.
- Post-FOFA there remains a lack of clarity relating to the distinction between Personal Advice and General Advice, and the uncertainty around providing limited or single issue scoped advice under the best interests duty. This raises a risk that changes may further reduce the ability to have simple conversations with customers about their financial needs.
- CommBank supports the inclusion of credit as an option for licensed financial advisers as it can help facilitate clients and their adviser's engaging in conversations on a broader range of financial needs, and on topics which naturally complement each other (for example debt management and savings).
- Broadening the scope of products financial advisers provide advice on would have practical implementation implications, for example additional training requirements, cost of changes to documentation and processes. These should be carefully considered.

Summary of Response to Draft Recommendations

- CommBank supports in principle ***Draft Recommendation 12.1 (Rename General Advice to improve customer understanding)*.**

Summary of Response to Draft Findings

- CommBank notes ***Draft Finding 7.1 (Consolidation in asset management and financial advice).***

Competition in wealth management

CommBank is committed to helping customers meet their wealth and retirement needs through the most appropriate channel. When it comes to delivering good customer outcomes, it is incumbent on all players to innovate and develop the best product and service offering.

The FSI undertook a thorough review of the financial services industry, including competition. The FSI specifically examined whether the recent trend of vertical integration is reducing competitive pressures, but did not conclude that regulatory intervention was necessary. It did, however, recognise a need to increase standards around financial product design and distribution and increase ASIC's powers over products and in regulation and draft legislation for this proposal is currently under consultation. It also acknowledged that the Australian financial system has matured, and robust FOFA legislation affords real consumer protection, including the best interests' duty and prohibitions on the payment of conflicted remuneration.

In relation to competition in superannuation and investments, it is important to distinguish between platforms and products. The platform is the administration vehicle which facilitates efficient access to the underlying investment products (or investment "options"). Platforms can be in-house or external, and some entities own more than one platform (for example, CommBank owns the FirstChoice and FirstWrap platforms). Platforms compete for financial advisers, as well as on products offered.

CommBank's financial advice licensees include multiple platforms and insurance providers on their Approved Product Lists (APLs). Of the investment options on the platforms which are owned by CommBank, less than 40% of the total options available are in-house products.

CommBank's financial advice business is required to comply with the Financial Services Council Life Insurance Approved Product List Standard which requires a licensee to hold a minimum number of life insurance products (three) on the APL and provide various disclosures to this effect. There is also an extensive off-APL process. Under this process financial advisers can recommend products/platforms not listed on the APL where they deem this to be in the best interests of clients.

Vertical integration can provide significant customer benefits by offering a wide range of financial products and services at each stage of their lives, with scale and scope benefits providing more choice, competitive pricing, and innovative technology.

Some industry stakeholders and commentators have presented vertical integration to be a feature only present in banking-owned wealth businesses, however, vertical integration is a common feature throughout financial services in Australia, and not unique to conglomerate banking businesses.

As the Commission has itself observed, the market continues to evolve. Some banks are exiting elements of their wealth management operations. In comparison, some industry superannuation funds are seeking to harness the benefits of vertical integration by internalising their asset management and developing financial advice. Some funds also own banking operations.

CommBank notes ***Draft Finding 7.1 (Consolidation in asset management and financial advice)***.

Proposal to rename General Advice

One of FOFA's key objectives was to increase access to advice for all Australians. Following the introduction of the FOFA reforms the cost of delivering quality advice remains high. This has challenged the industry's ability to increase access to advice.

CommBank supports the general proposition to increase access to advice and the safe delivery of information or guidance to customers. CommBank supports in principle ***Draft Recommendation 12.1 (Rename General Advice to improve customer understanding),*** however encourages any proposed changes to be considered in a broad context so that potential unintended consequences are fully understood and mitigated. CommBank is available to work with the appropriate bodies in this process. CommBank believes it will be important for sufficient consumer testing to take place to ensure the new name for General Advice has real meaning to the broader community.

There is the potential for unintended consequences if access to advice is not given primary consideration. In exploring changes to the naming of General Advice, policymakers should be careful to ensure access to simple, single issue advice and general guidance to customers on financial matters improves, or at the very least is not reduced as a result. It would be a poor public policy outcome to permit the delivery of factual information or full-scale Personal Advice only.

Consideration should be given to the relative benefit of any new name, vis-a-vis the cost and effort that would be required in helping Australians understand the practical meaning and the significant cost in training and documentation changes required on the part of institutions and individual advisers. Costs could be reduced by ensuring adequate transition timeframes by incorporating changes as part of planned update cycles.

CommBank would welcome more legal certainty between personal and General Advice (that is, where customer conversations begin to enter the realm of Personal Advice), including where advice is given on single or a more limited set of issues at the customer's request.

CommBank's preference is for greater scope and certainty around what is possible under General Advice and in delivering limited or single issue advice.

Proposal to extend scope of financial advice to include some credit products

CommBank appreciates the intent of proposals which aim to increase competition in the way consumers receive advice about lending products, for example through alternatives to mortgage brokers. Presently, only a very small number of advisers who provide financial advice under CommBank's licences are both financial advisers and are also authorised to provide credit advice through a credit licensee.

CommBank supports the inclusion of credit as an option for licensed advisers as it can help facilitate clients and their advisers engaging in conversations on a broader range of financial needs, and on topics which naturally complement each other (for example debt management and savings).

Such a change would inevitably result in the need for integrated businesses such as CommBank to invest additional resources to implement this measure, relating to additional training, the updating or addition of customer documentation, costs for research relating to product selection, system updates or access changes to provide more information to advisers, and the need to prepare additional distribution agreements. Overall, however, depending on how the change is implemented (for example consolidating licence obligations) there may be long term regulatory cost savings.

Currently a client-adviser conversation flow can be affected by a hesitation by the adviser not to delve into any realm of credit that at times may be critical in managing cash flow or finding funding sources (for example using reverse mortgages as an approach to unlock liquidity) for the client.

Any new rules in this area should continue to recognise differences in the way recommendations relating to credit products are regulated compared with other (wealth related) products and services.

It will be important that Government and industry work closely together to develop the details of this proposal as it develops to ensure any unintended consequences are avoided. CommBank is available to work with the appropriate bodies to develop detailed requirements.

Response to Information Requests

Information Request 12.1 Should the scope of financial advice be increased to include some credit products?

- As discussed above, CommBank supports the inclusion of credit as an option for licensed advisers as it can help facilitate clients and their adviser's engaging in conversations on a broader range of financial needs, and on topics which naturally complement each other (for example debt management and savings).

Information Request 12.2 Should General Advice be renamed to avoid customer confusion?

- As discussed above, CommBank supports the intent of the Commission’s recommendation to rename General Advice to improve customer understanding, however encourages any changes through the consideration of this proposal to avoid unintended consequences that could be detrimental to consumers accessing advice and guidance to meet their needs.

Cross reference of Draft Recommendations

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DR 7.1 A proportionate approach to risks non-ADIs pose	Unopposed	34
DR 7.2 Building an evidence base on integration	Unopposed	16
DR 8.1 Duty of care obligations for lender-owned aggregators	Does not support	53
DR 8.2 Mortgage broker disclosure requirements	Supports in principle	54
DR 8.3 Collection of home loan interest rate data	Unopposed	58
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DR 8.5 Lenders mortgage insurance refund	Unopposed	59
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DR 10.2 Making the ePayments code mandatory	Supports in principle	38
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DR 13.1 Data access to enable switching	Supports in principle	43
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DR 15.1 Statements of expectations for regulators	Supports in principle	30
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DF 6.1 Cost of APRA interventions on home loans	Reject	31
DF 7.1 Consolidation in asset management and financial advice	Note	66
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DF 8.1 Interest rates from brokers vs other channels	Reject	53
DF 8.2 Cost of home loans through brokers vs branches	Note	52
DF 8.3 If you have a high loan to value ratio, you are probably paying for it twice over	Reject	59
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DF 11.1 Market power in general insurance provision	Accept	62
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Glossary

ABA	Australian Banking Association
ACCC	Australian Competition and Consumer Commission
ADI	Authorised Deposit-taking Institutions
AHL	Aussie Home Loans
AIA	AIA Australia
APL	Approved Product List
AML	Anti-Money Laundering
ANZ	Australia and New Zealand Banking Group
APRA	Australian Prudential Regulation Authority
APS 120	Prudential Standard APS 120 Securitisation
ASIC	Australian Securities & Investments Commission
Australia's Major Banks	Australia's four largest banks: ANZ, CommBank, 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
CEO	Chief Executive Officer
CET1	Common Equity Tier 1
CFR	Council of Financial Regulators
CIBC	Canadian Imperial Bank of Commerce
Citi	Citibank
CMA	Competition and Markets Authority (UK based)
CommBank	Commonwealth Bank of Australia's Australian operations (unless otherwise specified)
Consumer	Retail banking customer
Core Europe	UK, Germany, France and Belgium
CTF	Counter Terrorism Financing
EFTPOS	Electronic Funds Transfer Point of Sale
EMV	Europay, Mastercard, Visa
FCA	Financial Conduct Authority (UK based)
FinTech	Financial technology; or start-ups / SMEs innovating within financial technology
FOFA	Future of Financial Advice
FSI	Financial System Inquiry
FY	Financial Year
GFC	Global Financial Crisis
Government	The Government of Australia
HSBC	Hong Kong and Shanghai Banking Corporation Limited
IRB	Internal ratings-based
JPM	J.P. Morgan
KYC	Know your customer
LIE	Loan Impairment Expense

LMI	Lenders Mortgage Insurance
LVR	Loan to Value Ratio
MFI	Main Financial Institution
NAB	National Australia Bank
NDA	Non-Disclosure Agreement
NIM	Net Interest Margin
NPP	New Payments Platform
NPPA	NPP Australia, the company that oversees the build and operation of the New Payments Platform
OECD	Organisation of Economic Cooperation and Development
OSP	Overlap Service Provider
PEXA	Property Exchange Australia Ltd
PIN	Personal Identification Number
PNC	PNC Financial Services
POS	Point of Sale
PPF	Purchased Payment Facility
RBA	Reserve Bank of Australia
RBC	Royal Bank of Canada
RBS	Royal Bank of Scotland
RegTech	Regulatory technology
ROE	Return on equity
Schemes	Payment networks such as Mastercard and Visa
Sedgwick	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
Treasury	The Treasury of Australia
UK	United Kingdom
USA	United States of America
WBC	Westpac Banking Corporation